IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1253

LESLIE W. NIMMO, et al.,

Petitioners,

vs.

CHARLES S. GRAINGER, et al., on behalf of themselves and others,

Respondents.

PETITION FOR CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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The petitioners, Leslie W. Nimmo and Nimmo & Associates, Inc., respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in this action on February 18, 1977, in which rehearing en banc was vacated and rehearing denied on November 17, 1977.

I. PARTIES

Your petitioners are Leslie W. Nimmo, an Illinois resident and retired executive of Great States Life Insurance Company, an Illinois corporation ("Great States"), and Nimmo & Associates, Inc., an Illinois corporation, which, however, was dissolved prior to institution of this litigation. Your petitioners

together owned a controlling interest in Great States prior to its merger in 1968 into State Security Life Insurance Company, an Indiana corporation ("State Security").

Charles S. Grainger, Annie Marie Henson (successor to her husband Marvin Henson, Jr., who died December 31, 1971), Lawrence A. Wadsworth and James William Parsons are residents of Alabama and brought this suit in 1969 as plaintiffs in behalf of themselves and other purchasers of certain participating life insurance policies issued by Great States. State Security, whose capital, petitioners understand from one of plaintiffs' briefs, was declared impaired by the Insurance Commissioner of Indiana in spring of 1977, was also a defendant in this case below.

II. OPINIONS BELOW

The opinion of the Fifth Circuit dated February 18, 1977, holding that these life insurance policies could become "securities" under the Federal Securities Laws, is reported at 547 F.2d 303, and appears in the appendix hereto at pages A-6 et seq. Rehearing en banc, pursuant to petitioners' timely petition, was granted on May 25, 1977 (553 F.2d 1008), but, after briefs were submitted and oral argument had, was vacated and then rehearing denied by the panel on November 17, 1977 (A-14). Petition for reconsideration of vacation of the rehearing en banc was then denied by the writing judge in behalf of the en banc court on December 12, 1977 (A-16). The order and opinion of the U. S. District Court for the Northern District of Alabama, dated June 5, 1975, which held these life insurance policies not to be "securities" appears in the appendix hereto at pages A-18 et seq.

III. JURISDICTION

Federal jurisdiction is based on the Federal Securities Laws (see below); and jurisdiction of this Court is invoked by its authority to grant writs of certiorari under 28 U.S.C. 1254(1). Extensions of time for filing this petition were granted to March 10, 1978 (which is, however, within 90 days of the above December 12 order).

IV. QUESTIONS PRESENTED

The basic question presented for review is:

Can a life insurance policy containing a standard participating provision, or an endowment life insurance policy, become a "security" under the Federal Securities Laws?

A subsidiary question, invoking the supervisory jurisdiction of this Court, is whether a court of appeals is properly following the intent of Rule 56 of the Federal Rules of Civil Procedure pertaining to the granting of summary judgment when, even though depositions had been taken, affidavits filed and summary judgment rendered, the court of appeals expressly treats the case as if it were appealed from a bare motion to dismiss without any discovery and, after vacating a rehearing en banc, remands the case apparently for the taking of additional testimony.

V. STATUTES AND RULES INVOLVED

This case arises under the Federal Securities Laws, in particular the Securities Act of 1933, as amended ("the 1933 Act"), 15 U.S.C. 77a et seq., and the Securities Exchange Act of 1934, as amended ("the 1934 Act"), 15 U.S.C. 78a et seq. The principal provisions involved, which are set forth in the appendix, are: Sections 2(1) and 3(a)(8) of the 1933 Act; Sections 3(a)(10) and 10b of the 1934 Act and Rule 10b-5 thereunder; the McCarran-Ferguson Act; and a provision of the Illinois Insurance Code (Sec. 845) governing participating insurance policies. Of course, if these insurance policies are deemed to be "securities", then all of the registration and reporting provisions of the 1933 and 1934 Acts become applicable.

VI. STATEMENT OF THE CASE

This case squarely presents the question of whether participating endowment life insurance policies can become "securities" under the Federal Securities Laws. The policies were sold by Great States in 1962, and among the purchasers in Illinois and elsewhere were four purchasers in Alabama who brought

this class action, claiming $3 million in damages (plus attorneys fees and $10,000 punitive damages for each policyholder). The policy contains all of the standard provisions of an endowment insurance policy. Without burdening this Court on petition for certiorari with the entire instrument, the contract, which plaintiffs claim is a "security", begins as follows:

> "Great States Life Insurance Company of Quincy, Illinois, will pay the sum insured under the conditions hereof to the Insured on the Maturity Date if then living, provided all coupons hereon have been left with the company to accumulate at interest."

Both the sum insured and the amounts of the coupons are fixed dollar amounts as to which the policyholder bears no risk. The policy continues,

> "If the death of the Insured occurs before the Maturity Date, the Company will pay to the Beneficiary named, the Sum Insured upon receipt at its home office of due proof of the death of the Insured."

The policy then continues with various other provisions common to insurance contracts, such as a return premium rider payable in the event of death during the first ten years, settlement options, loan provisions, provisions for paid-up insurance and endowment privileges, and the non-forfeiture options required by state insurance laws and regulations.

At the bottom of page numbered 2 of the policy, is the participating provision (A-41-2) that has apparently created this litigation, which provision is a standard form used by stock insurance companies, and is set forth verbatim in Exhibit A to this petition, where it is compared with a sample participating provision contained in Huebner & Black, *Life Insurance* (8th Ed., 1972), 822. There is no special fund or account, the profits from which will determine the death benefit or cash values of the policy.

The Great States policies also had attached to them a series of coupons denominated "Guaranteed Premium Reduction Coupons", which could be used to reduce premiums payable in future years, to purchase additional paid-up insurance or ap-

plied to other options at the wishes of the policyholder. The coupons were in fixed dollar amounts.

There was attached to some of the policies sold, including those sold to the named plaintiffs in Alabama, an extract from the Illinois Insurance Code (Sec. 845) that required that 90% of the profits on participating policies (not the profits of the entire company) "inure to the benefit of the participating policyholders" (A-3). The extract from Illinois law attached to the policies sold plaintiffs had at the bottom of it the notation: "(All V.I.P. contracts issued by Great States Life Insurance Company in any state will be governed by this section insofar as the percent of profit is concerned)." Except for the above reference, the words "V.I.P. contract" appear nowhere in the insurance policies sold plaintiffs. The phrase "Variable Investment Plan" is, however, placed at the top of projection sheets given plaintiffs, in which the words "investor" and "investment" appear, showing the various cash and insurance benefits under the policies at selected years.

All insurance policies (except one-year term insurance) must have an investment element in order to provide for the payment of level premiums, and this investment element increases as one moves from ordinary life to endowment policies. The Great States policy was a 25-year term endowment and, thus, would have a high investment element. Plaintiffs' affidavits indicate the Great States policies sold them were sold as investments or investment policies, i.e. on the basis of the investment element of the endowment policies. The participating feature was also emphasized, and it was represented that after the first few years the dividends would be sufficient to pay the premiums and, in one case, a 40% profit. The District Court, after considering this evidence concluded, "At most, plaintiffs indicate that the salesmen treated the 'V.I.P.' insurance contract as if it were a 'security'," stating further in fn. 25, "Plaintiffs underscore the use of the word 'investment' in the contract and in the sales pitch. Although this term is subject to much abuse, it seems indisputable that insurance is usually a form of 'investment'. See *VALIC, supra,* 359 U.S. at 75 (Brennan, J., concurring).

Use of this term hardly warrants a finding that the contract here in issue was a 'security'." (A-46).

Great States initially adopted a dividend scale designed to pay out 90% of profits on the participating policies. This scale was adopted in early 1962, and a little over four years later in mid-1966 after experience showed that the profit projections on which the scale was based were not being realized, the company, in consultation with the Carl A. Tiffany & Company, Consulting Actuaries in Chicago, reduced the scale almost 50%. Great States, however, never made any profits on its ordinary (as opposed to group) life business – see Best's Insurance Reports–Life; and testimony in depositions taken by plaintiffs shows the reduced scale was adopted because Great States was paying dividends without having any profits.

Great States did not set up the separate accounting required by Illinois law nor has its successor State Security. However, "At present, State Security maintains a statutory reserve for the payment of benefits and obligations due under the V.I.P. policies." (A-27).

The relationship between premium and death benefit became an issue in this case as a result of the Fifth Circuit's initial decision, which set forth factors it considered relevant that would subject substantially all endowment policies to the Federal Securities Laws – see discussion under "Endowment Feature" at Part VII(1)(b), *infra*.

The District Court, in a comprehensive opinion, found that the life insurance policies here involved were not "securities" under the Federal Securities Laws (A-18 et seq.). On appeal, however, the panel of the Fifth Circuit held that the circumstances of their sale might cause such participating policies to become "securities" (A-6 et seq.). We ask this Court to note here that the District Court's decision was made on motion for summary judgment after the taking of eight depositions and submission of affidavits, whereas the Fifth Circuit declined to consider that status of the case and wrote its opinion erroneously as if the case had been appealed from grant of a motion to dismiss with barring of discovery.

Rehearing en banc was granted on May 25 of last year. At invitation of the Fifth Circuit, the SEC filed a brief and participated in the oral argument as amicus curiae. The SEC in general supported plaintiffs' position on the rehearing. In addition, another insurance company, National Insurance Company of America, filed an amicus curiae brief supporting defendants' position. NICOA was a defendant in a case argued at the same time and in which the *Grainger* opinion was incorporated by reference. ***Hilgeman v. National Insurance Company of America***, 547 F.2d 298 (5th Cir. 1977) (which, in addition, involved a number of complicated procedural issues).

After all the briefs had been submitted and oral argument held, the Fifth Circuit, however, vacated the rehearing, Judge Hill dissenting, and sent the case back to the initial panel, which then on November 17, 1977, denied rehearing (A-14). A petition for reconsideration of vacation of the rehearing en banc was denied on December 12 by the judge who wrote the initial panel opinion, issuing the order in behalf of the court (A-16). Stay of the court's mandate was granted on December 8 and a motion for extension of the stay was denied on January 25, 1978, each by the judge who wrote the opinion.[1]

Most of the named plaintiffs have also brought suits in the state courts, thus illustrating clearly that securities suits are not their only choice of legal action. Plaintiff Henson's case has even been appealed to the Alabama Supreme Court; and he has, thus far, lost on some counts and succeeded on others — see ***State Security Life Insurance Co. v. Henson***, 288 Ala. 497, 262 So. 2d 745 (1972). Plaintiffs Grainger and Wadsworth have similar suits pending in the Circuit Court of Jefferson County, Alabama — Nos. 21315 and 21316. At this point, it is appropriate to note that defendants recognize that plaintiffs in no way should be barred from their right to litigate any claims of fraud or breach of contract that they may feel they have. However, that should be done by individual or class suits in the

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[1]Issuance of the mandate, however, does not destroy the power of this Court to review the lower court's judgment—see Stern & Gressman, *Supreme Court Practice* (4th Ed., 1969), Sec. 17.16 and cases therein cited.

proper state forum without trying to force these life insurance policies into the mold of a "security" under the Federal Securities Laws and, thus, greatly broadening the scope of those laws.

VII. REASONS FOR GRANTING THE WRIT

The panel of the Fifth Circuit has held (A-15) that in the sale of participating endowment insurance policies, "The totality of the circumstances surrounding their sale, including any oral representations made," can cause the policies to become "securities" under the Federal Securities Laws. By creating potential securities out of all such policies, the Fifth Circuit has greatly expanded the scope of those laws far beyond what defendants submit was the intent of Congress and has placed the Federal Courts in the business of policing, not a new field, but the historic field of life insurance policies. Such an expansion is contrary to the principles enunciated in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), *United Housing Foundation v. Forman*, 421 U.S. 837 (1975), and related cases recently decided by this Court, as discussed in Part (3) below, which have rejected expansion of implied remedies under Rule 10b-5. The decision of the Fifth Circuit is also in conflict with a 1969 decision of the Tenth Circuit (see Part (2) below) and is certainly an issue of national importance in interpretation and administration of the Federal Securities Laws since whether a company must register its participating or endowment policies or be subjected to 10b-5 class suits on them is clearly of great importance.

(1) The Holding of the Court of Appeals that a Life Insurance Policy with a Standard Participating Provision, or an Endowment Life Insurance Policy, can Become a "Security" is Erroneous, Conflicting in Principle with Decisions of this Court, and is an Issue of National Importance in Interpretation of the Federal Securities Laws.

At issue is a participating endowment life insurance policy issued by Great States. The District Court, after the taking of depositions and submission of affidavits in connection with motions for summary judgment, rendered a comprehensive opin-

ion, which was obviously heavily researched (A-18 et seq.), that these participating policies did not constitute "securities". Although the panel of the Fifth Circuit stated on rehearing that it had not yet held such policies to be securities, its "totality of circumstances" test, "including any oral representations made" (A-15), makes any policy where any of such circumstances exist a potential security subject to a 10b-5 class suit. Petitioners submit that this is contrary to principles enunciated by this and other courts, the legislative history of the 1933 Act and the views of learned commentators.

While the definitions of "security" in the 1933 and 1934 Acts (A-1) are broad, Section 3(a)(8) sets forth an exception to that definition for "any insurance or endowment policy", which, pursuant to court decisions and other authorities, is descriptive of the exclusion of such policies from coverage of the Federal Securities Laws. *Tcherepnin v. Knight*, 389 U.S. 332 at 342, n. 30 (1967), where as analyzed by this Court,

> "Congress specifically stated that 'insurance policies are not to be regarded as securities subject to the provisions of the Act,' H.R. Rep. No. 85, 73d Cong., 1st Sess., 15 (1933), and the exemption from registration for insurance policies was clearly supererogation."

To the same effect is 1 Loss, *Securities Regulation*, pp. 496-97 (2d Ed., 1961). Since the definition is virtually the same in the 1934 Act and the two acts are *in pari materia*, life insurance contracts are not included under either act.[2]

The panel of the Fifth Circuit seemed to be questioning, however, whether the Great States policy, even though having standard participating and endowment provisions, was an insurance policy since, in its denial of rehearing, it referred, for example, to endowment policies, placing those words in quotation marks. Reference briefly to comparable provisions and case and

[2]"The definition of a security in the 1934 Act is virtually identical and, for present purposes [whether instruments are "securities" within the purview of the 1933 Act and the 1934 Act], the coverage of the two Acts may be considered the same." *United Housing Foundation v. Forman, supra*, at 421 U.S. 847, n.12.

other authority shows, however, that the Great States policy described above under "Statement of the Case" is a standard form of participating endowment policy.

(a) **Participating Feature.** That the participating feature of the Great States policy is a standard participating provision should be clear from the comparison of it with the same provision of the sample participating life policy contained in Huebner & Black, *Life Insurance* (8th Ed., 1972), p. 822, attached as Exhibit A to this brief, where the Court will note the extreme similarity. Both provisions provide that the divisible surplus accruing on the policy shall be ascertained annually and shall be available under certain options, including payment to the policyholder in cash, application toward payment of renewal premiums, or purchases of paid-up additional insurance.

Such participating provisions are commonplace in the insurance industry and, in fact, are a part of all policies issued by mutual life insurance companies. The dividends are, in effect, a refund of premiums based upon the three factors that affect the divisible surplus of insurance companies: (1) Favorable mortality experience, (2) return on investment, and (3) savings in expenses. See the District Court opinion at A-42 and authorities therein cited.

Plaintiffs' contention, which is the genesis of this litigation, is that the participation provision caused these life insurance policies to become "securities". As stated in their main appellate brief (at p. 35), they contend the insurance exemption or exclusion should be limited to "non-participating policies of pure risk 'insurance' ", which would, thus, restrict it to term insurance.

That such a position is in conflict with principles enunciated by this Court is shown in *SEC v. Variable Annuity Life Insurance Co.*, 359 U.S. 65 (1959) ("VALIC"), where this Court rejected VALIC's argument that the SEC's position (to subject variable annuities to the securities laws) would make a participating policy a "security". As stated in the comprehensive concurring opinion of Mr. Justice Brennan, writing for himself and Mr. Justice Stewart:

"The respondents seek to equate this contract (the variable annuity) with a fixed-dollar 'participating' annuity sold by a mutual company, or one sold by a stock company on a participating basis. This contention is not persuasive. While investment experience in a 'participating' contract can redound to the benefit of the policyholder, the contracts are sold as fixed-dollar obligations. The 'dividends' are promoted as such. During the pay-in period, they might be thought of as a reduction of premium. They may very well represent favorable mortality risk experience, particularly where the company's investments are conservative." 359 U.S. at 89-90.

Thus this Court has clearly distinguished between policies with variable face amounts depending on the investment experience of a special fund, on the one hand, and the participating features of fixed dollar insurance policies, such as that involved in this case, on the other hand.

"Participating insurance accounted for $1,502 billion or 59% of all life insurance in force with U. S. companies at the end of 1976," *Life Insurance Fact Book '77*, American Council of Life Insurance, Washington, D. C.; and participating insurance was certainly well-known at the time of enactment of the Federal Securities Laws. Thus, it should be clear that a participating provision — and certainly a standard one as is involved here — should not convert a life insurance policy into a "security". To hold as did the Fifth Circuit in enunciating its "totality of circumstances" test, however, will potentially subject over one-half of the insurance in effect in the United States to the requirements of the Federal Securities Laws.[3]

[3]Plaintiffs and the panel of the Fifth Circuit placed great reliance on the provision of Section 845 of the Illinois Insurance Code (A-3) requiring that, in the case of companies selling both participating and non-participating policies, 90% of the profits on the participating policies shall inure to the benefit of the participating policyholders. However, as will be noted from the standard participating provisions set forth in Exhibit A, normally the amount that is apportioned to participating policyholders is dependent on discretion of the company's board of directors in allocating its divisible surplus. The Illinois provision, thus, is for the benefit of the policyholders in requiring the company to allocate 90% of the profits on the participating policies (not the profits of the entire

It should be noted that there is no special fund or account in the Great States policy similar to the so-called "flexible fund" involved in *SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202 (1967) ("United Benefit"). Thus, while the face amount of the Great States policy is fixed, the amounts of the annuities in *United Benefit* were, as stated on page 1 of the United Benefit policy:

> "Prior to the Maturity Date, the value of this policy is *not guaranteed* other than as specifically provided herein, but will depend upon the *investment experience* of Flexible Fund A." (Emphasis supplied.)

The Illinois Insurance Code (A-3) required companies issuing participating policies to "keep a separate accounting for each class of business", i.e., some form of cost accounting; but it did not require a separate fund or separate account as in *United Benefit* that might determine the face amount of the policy.[4] Consequently, because of the absence of any special fund or account, this case is completely distinguishable from both *VALIC* and *United Benefit* although plaintiffs would seek to have them treated the same.

(b) **Endowment Feature.** Section 3(a)(8) of the 1933 Act enumerates:

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company itself) to those policies; in other words, it is a restriction on the discretion of the board of directors. We submit the panel of the Fifth Circuit is surely in error in intimating that attaching such a provision to the policies might cause them to become "securities". To illustrate, as to those policies sold in Illinois, it would become part of the policy by operation of law whether attached to it or not. It would indeed be strange if a provision enacted pursuant to protective state regulation were somehow to cause policies subject to that state regulation also to become "securities" notwithstanding the McCarran-Ferguson Act, 15 U.S.C. 1012, reserving regulation of the business of insurance to the states. We submit, therefore, that such a construction would be completely contrary to the intent—and, in fact, express language—of Congress.

[4]The panel of the Fifth Circuit, thus, was in error when it stated at 547 F.2d 304-05 (A-7) that Illinois law:

> "[R]equired companies offering both participating and non-participating policies to keep separate accounts . . ."

"(8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner," etc.

Pursuant to the decisions of this Court, the legislative history of the 1933 Act and commentators such as Professor Loss, all referred to above in the discussion of Section 3(a)(8) at page 9, this provisions is descriptive of the exclusion of such policies from the coverage of "security" in both the 1933 and 1934 Acts. Endowment policies were certainly well-known and in existence at the time of enactment of the Federal Securities Law and, thus, were certainly excluded from their coverage. However, in its initial opinion on appeal, the panel of the Fifth Circuit suggested that the premium/death benefit ratio might be sufficient to convert a life insurance policy into a security.[5] Then, in the short opinion on denial of rehearing, the panel still indicated that the relationship between premium and death benefit "is a proper factor for consideration" in determining whether these life insurance policies might be "securities".

It is obvious that the premium/death benefit ratio is lowest in term insurance but, because of the guarantee of greater benefits, increases for ordinary life insurance and is higher for endowment insurance policies. The ratio will usually be higher for a term endowment than for one maturing, for example, at age 65 since, in the former, premiums will be paid for only 20 or 25 years while, in the latter, they will usually be paid for a longer period. Plaintiffs have, accordingly, referred to the Grainger policy in an effort to show the premium was too high.

[5]The panel for that purpose cited now rescinded Rule 3c-4 adopted by the SEC under the Investment Company Act of 1940 in administrative proceedings pertaining to variable life insurance contracts, i.e., life contracts with variable face amounts as contrasted with the fixed face amounts involved in the policies in the present case. The schedule set forth in Rule 3c-4, however, was based on ordinary life policies under which it was assumed premiums would be paid at least until age 65. Therefore, the so-called "industry norms", which the panel referred to at headnote 5 of its opinion and upon which it was judging whether an insurance policy might be a "security", could never be met by endowment policies since by their inherent nature they must have higher premiums.

That policy was a $10,000 25-year term endowment policy with a gross premium of approximately $400. However, although the panel of the Fifth Circuit seems to have felt that the premium was excessive, it is clear by comparison that it was in accord with premiums charged in the same year by substantial companies in the insurance industry.[6]

Does the Fifth Circuit's opinion, therefore, mean that all endowment policies — and certainly all term endowments — must now be registered under the 1933 Act? This would appear to be true since there is certainly an investment element in endowment policies (even though they have heretofore been considered excluded from the definition of "security"). In any event, it is certain that under the Fifth Circuit's decision, the doors of the courthouse have been opened for all disappointed purchasers of endowment life policies to bring a 10b-5 action on the ground that there was some misrepresentation in their sale, a result that would significantly expand coverage of the Federal Securities Laws and doubtless involve the Federal Courts through 10b-5 actions in regulation of the business of insurance in conflict with the McCarran-Ferguson Act, 15 U.S.C. 1012.[7]

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[6]The Grainger $10,000 policy, with a gross premium of approximately $400, was sold in 1962 to an insured aged 2 (although the Great States policy was not limited to juvenile insurance but was sold to applicants of all ages). In that same year 1962, the then largest mutual insurance company in the United States, Metropolitan Life, was quoting a premium of almost $500 for a 20-year endowment for a person the same age, which, adjusting to the 25-year period used by Great States, would approximate a premium of $400 (without any privilege of premium reduction through the use of coupons if so elected as was possible under the Great States policy). In 1962, Northwestern Mutual also had a term endowment similarly priced. See *Flitcraft Compend* (1962). *Flitcraft* is a standard copyrighted text, published annually and independently from any insurance company, that sets forth quotations for various life insurance policies issued by the leading life companies doing business in the United States.

[7]A further factor relied upon by the Fifth Circuit to cast these insurance policies into the mold of "securities" was the fact that these were coupon policies. The panel stated, "Attached coupons physically resemble coupons often attached to bonds." Apparently the theory is that because bonds have coupons and they are securities, a participating life insurance policy having attached "premium reduction coupons" might also be securities. We submit such a theory is stressing form over substance since the coupons

(c) **"Method of Sale" will not Convert Participating or Endowment Policies into "Securities".**

It would seem logically to follow that, if insurance policies are not securities — and the participating and endowment features set forth above are standard to policies historically considered not to be securities — then the method of sale of a policy could not cause it to become a "security". However, the panel of the Fifth Circuit has held to the contrary, stating that a court must consider "the totality of the circumstances surrounding their sale, including any oral representations made, in determining whether defendants were selling securities" (last sentence, first paragraph of denial of rehearing, A-15).

That such a position is in conflict with the authorities previously set forth becomes apparent when it is recognized that all forms of insurance (except one-year term insurance) must contain an investment element in order to permit level premiums. It was clear in 1933 that insurance policies did have significant investment elements; but despite their existence, insurance policies were excluded from coverage of the securities laws. This investment element will range from ordinary life to various types of endowment policies where it must of necessity be larger because of the greater fixed benefits contracted to be paid as is the case with the policy involved here. Thus, if an insurance agent fully describes the policy he is selling, he must describe its investment element. To hold otherwise would be to require

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are in fixed dollar amounts and can be used to reduce premiums or to purchase paid-up additional life insurance, which shows their clear relation to the life insurance policy to which they are attached. The District Court in analyzing them concluded (A-43):

> "Such coupon policies are not widely used, but they are a standard form of insurance. 1 Appleman, supra (*Insurance Law & Practice* (Rev. Ed., 1965)), Sec. 10. In effect the coupons are a guaranteed dividend, or rebate of premium. They are not premised upon a share in an investment pool and in no way represent a 'security'."

Turning to this Court's recent decision in *United Housing Foundation v. Forman, supra,* if naming the instrument construed there as "stock" did not create a "security", then surely including these coupons of fixed value on life insurance policies with fixed face amounts should not make them "securities".

a withholding of facts material to the purchaser of the policy; and, as this Court well knows, it is commonplace to show a prospective insured a table of anticipated cash values his policy will have.

As this Court is also well aware, billions of dollars of insurance are outstanding under policies of both mutual and stock companies that have participating and endowment features. Under the Fifth Circuit's decision, these policies, all of which must have an investment element, can, if an agent emphasizes the investment element of the policy, become "securities" but, if no mention is made of it, they apparently will not. Consequently, companies will be placed in an impossible position because of the *ad hoc* nature of the Court's decision since the same policy could be a "security" if sold in one manner and not if sold in another; and, thus, there will be no sure means under which a company can assure itself that its policies will not be subject to all of the Federal Securities Laws. As a result, the decision will subject a large segment of the American economy to large class actions and indeterminate liabilities for indeterminate amounts as criticized in *Blue Chip Stamps* and other decisions of this Court referred to in Part (3) below.[8]

Plaintiffs and the panel of the Fifth Circuit ground their holding that manner of sale can convert an insurance policy into a "security" on *SEC v. Joiner Leasing Corp.*, 320 U.S. 344 (1943) (which held sale of interests in oil and gas leases coupled with an agreement to drill an exploratory well constituted a security), and as it was later applied in cases involving chinchilla and similar enterprises, Scotch whiskey receipts or rare coin portfolios. However, we submit it is clearly erroneous to apply

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[8]By comparison, variable annuities and variable life insurance contracts have been held either by the courts or the SEC to constitute securities since they involve investment in a separate fund consisting of equities. In those cases, the company will know in advance that such a contract must be treated as a security. On the other hand, in the case of standard insurance provisions, such as participating or endowment features (which do not involve such investment funds), the insurance company will have no way of knowing in advance whether or not the policy will be subject to the securities laws.

it to participating or endowment insurance policies since, because of the inherent nature of insurance, such policies must have investment elements but are excluded from the securities laws under the express language of Congress, court decisions and commentators thereon cited above. So to apply *Joiner* would negate that exclusion.

(2) The Holding of the Fifth Circuit that a Life Insurance Policy with a Standard Participating Provision Can Become a Security is in Conflict with the Tenth Circuit.

The Tenth Circuit in *Olpin v. Ideal National Insurance Co.,* 419 F.2d 1250 (10th Cir. 1969), cert. den. 397 U.S. 1074 (1970), dealt with another form of participating provision and held that it did not cause the policy to become a "security" under the Federal Securities Laws. That participating feature was described as a "bonus fund endorsement" and was unlike the standard form involved in the present case. In addition, the sales literature used in that case (and quoted by the court at 419 F.2d 1253-4) referred to "investment" on repeated occasions; but the bonus endorsement there being construed was, nevertheless, held not to constitute a "security". Thus, the Tenth Circuit, in contrast to the Fifth Circuit here, has held that a participating insurance policy (even though not a standard one as is present here), coupled with investment language in its sale, would not constitute a "security" under the Federal Securities Laws.

(3) The Decision of the Fifth Circuit is Contrary to Recent Decisions of this Court Rejecting Expansion of Implied Remedies under the Federal Securities Laws.

This Court, in a line of recent comprehensive decisions, has rejected expanded interpretations of provisions of Rule 10b-5 such as are the result of the decision of the Fifth Circuit. Among these decisions are the following:

(i) *Blue Chip Stamps v. Manor Drug Stores, supra,* reversing the Ninth Circuit and holding that non-purchasers have no standing to bring actions under Rule 10b-5;

(ii) *United Housing Foundation v. Forman, supra,* reversing the Second Circuit and holding a document entitled "stock" was not a "security" when it was in fact a participation in a cooperative housing unit;

(iii) *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976), reversing the Seventh Circuit and holding that under Rule 10b-5, intent or scienter is needed for liability and not merely negligent conduct;

(iv) *Piper v. Chris-Craft Industries,* 51 L. Ed. 2d 124 (U.S., 1977), reversing the Second Circuit and refusing to imply liability under Section 14e of the 1934 Act and Rule 10b-6 for alleged fraudulent and manipulative conduct in connection with a tender offer; and

(v) *Santa Fe Industries v. Green,* 51 L. Ed. 2d 480 (U.S., 1977), reversing the Second Circuit and holding Rule 10b-5 inapplicable to the terms of a Delaware short-form merger.

The above cases show clearly the prevailing doctrine of this Court that the securities laws should not be expanded into new fields of implied remedies. Especially would that doctrine be applicable where the result would require court review of a whole new field of commerce, such as insurance policies with participating or endowment features, which Congress sought to exclude from coverage. That such a result would be contrary to the underlying theory of Rule 10b-5 is clearly shown in *Blue Chip Stamps* where this Court ruled that the *Birnbaum* rule, which limited plaintiffs in 10b-5 fraud actions to purchasers and sellers of securities, would not be relaxed so as to allow potential purchasers or sellers to maintain such actions. In so doing, the opinion of the Court discusses at length the dangers of determining securities law liability on an *ad hoc* basis and of opening up new areas for litigation under the Federal Securities Laws. Specifically, the Court stated:

> "Were we to agree with the Court of Appeals in this case, we would leave the Birnbaum rule open to endless case-by-case erosion depending on whether a particular group of plaintiffs was thought by the court in which the issue was

> being litigated to be sufficiently more discrete than the world of potential purchasers at large to justify an exception. *We do not believe that such a shifting and highly fact-oriented disposition of the issue of who may bring a damage claim for violation of Rule 10b-5 is a satisfactory basis for a rule of liability imposed on the conduct of business transactions.*" 421 U.S. at 755 (Emphasis supplied.)
>
> "The abolition of the Birnbaum rule would throw open to the trier of fact the many rather hazy issues of historical fact proof of which depended almost entirely on oral testimony. We in no way disparage the worth and frequent high value of oral testimony when we say that *dangers of its abuse appear to exist in this type of action to a particularly high degree.*" 421 U.S. at 743 (Emphasis supplied.)

All of the dangers articulated by this Court for not relaxing the *Birnbaum* rule are greatly magnified by the Fifth Circuit's decision in this case. Under that decision, there must necessarily be an "endless case-by-case" approach to determining which insurance policies are to be treated as subject to the Federal Securities Laws. Each case will necessarily depend on a "shifting and highly fact-oriented disposition" of the issue of "manner of sale". In addition, where a plaintiff can claim an alleged common question of law or fact — whether susceptible of ultimate proof or not — the "in terrorem" aspect of such litigation criticized in *Blue Chip Stamps, supra,* will also clearly be present, as shown by plaintiffs' present class suit for $3 million plus attorneys' fees and punitive damages brought against an insurance company and the former controlling stockholder of its predecessor.

There can be no policy — no matter how conventional — that could not, under the Fifth Circuit's decision in this case, be found to be a security if the plaintiff asserts that the investment element was overemphasized in its sale. Henceforth, no insurance company could safely forecast whether what was heretofore considered to be a conventional life insurance policy must be registered under the 1933 Act or will be made the basis for a 10b-5 class action under the 1934 Act. It will be impossible for counsel to advise clients whether a given policy should be regis-

tered since, depending on the "totality of circumstances" test, it always can potentially be a "security". As a result, the panel's decision will place heavy burdens and risks on the insurance industry — not to mention the burdens on the courts in regulating the insurance business through handling such litigation.

(4) This Court has Recently Accepted Certiorari in Another Case Involving Expansion of Implied Remedies under Rule 10b-5.

This Court has recently granted certiorari to the Seventh Circuit to review its decision in *Daniel v. International Brotherhood of Teamsters*, etc., 261 F.2d 1223 (7th Cir. 1977), in which that circuit held that interests in non-contributory pension plans under collective bargaining agreements were securities for purposes of Rule 10b-5. 46 U.S.L.W. 3512 (U.S., Feb. 21, 1978).

Although the statutory context of that case is different,[9] if this Court reverses that decision of the Seventh Circuit and, hence, rejects such a broad expansion of coverage of Rule 10b-5, then it would be only consistent to reject the similar broad expansion under the decision of the Fifth Circuit in this case that will create potential "securities" out of all participating or endowment life insurance policies.

(5) The Court of Appeals, by Erroneously Treating the Case as if it were Appealed from a Motion to Dismiss Without any Discovery, Failed to Give Effect to the Intent of Rule 56, F.R.C.P., Providing for Granting of Summary Judgment.

We recognize that plaintiffs in opposition to this petition may urge that the Fifth Circuit remanded the case and, thus, that it is not ripe for decision by this Court. However, that remand-

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[9]The Seventh Circuit expressly ruled that the pension interests in *Daniel* were exempt from the registration provisions of the 1933 Act and the reporting provisions of the 1934 Act. In the instant case, however, insurance and endowment policies, under the legislative history, decisions of this Court and views of learned commentators referred to above under Part (1), should be excluded from being "securities" under all the Federal Securities Laws. As a consequence, regardless of the deposition of *Daniel*, the statutory context shows that *Grainger* should be reversed.

ment is based on a completely mistaken view of the procedural posture of the case.

The District Court, by its order of June 20, 1972 (A-17), elected "to treat the motion to dismiss filed in behalf of each defendant as a motion for summary judgment" and to allow the parties to submit any affidavits or other documentary evidence which they may deem relevant to determination of whether the insurance contracts involved constituted "securities". There had been no order blocking discovery as erroneously indicated in the panel decision at 547 F.2d 305 (headnote 1), and the District Court had before it extensive depositions, most of which were taken by plaintiffs. Plaintiffs also filed affidavits as to the facts upon which they were relying and, consequently, the District Court did consider that evidence, as appears clear from the fact that it stated in its opinion the nature of the case "warrants the consideration of more evidence than is usually appropriate to motions to dismiss" (A-23). Nevertheless, plaintiffs and the Fifth Circuit seem to wish to remand this case for further testimony and other proceedings.

The Advisory Committee Notes on Rule 56 characterize summary judgment as a "salutary device" and as "in the interest of more expeditious litigation". Petitioners submit that, considering the correct procedural posture of the case, it was highly inappropriate for the Fifth Circuit to disregard that procedure and to remand the case as if it were decided on a motion to dismiss and as if there had been an order barring discovery. Such a procedure is contrary to the basic principle of use of Rule 56 to expedite litigation and can only serve to burden the dockets of the lower courts by requiring additional time and unnecessary proceedings.

Such a procedure also appears contrary to the Fifth Circuit's own decision in *Surkin v. Charteris*, 197 F.2d 77 (1952), holding, "The opposing party (opposing the motion for summary judgment) must sufficiently disclose what the evidence would be to show that there is a genuine issue of fact to be tried." Plaintiffs' last depositions were noticed in 1970; and if they had

some other evidence that they thought would somehow convert these insurance policies into securities, then it should not be their privilege after all these lengthy proceedings now to claim that there is a material dispute as to facts (as contrasted with interpretations to be placed on them) not disclosed before the lower court. In this connection, it is noted that the foregoing decisions in *Blue Chip Stamps, United Housing* and *Santa Fe Industries* by this Court and *Ideal National* by the Tenth Circuit were all decided on motions to dismiss, whereas this case has been decided against the background of more extensive discovery proceedings prior to disposition on motion for summary judgment.

Further proceedings, in disregard of the posture of the proceedings in the lower court, will only continue to give this $3 million class suit the "in terrorem" effect criticized by this Court in *Blue Chip Stamps, supra.*[10] That the failure to implement Rule 56 is a matter of concern to effective judicial administration, especially in federal securities litigation, was expressed in that case where this Court stated:

> ". . . In the field of federal securities laws governing disclosure of information, even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial *so long as he may prevent the suit from being resolved against him by dismissal or summary judgment.*" 421 U.S. at 740. [Emphasis supplied.]

The foregoing shows not only that this litigation is in an appropriate procedural stage to be brought before this Court but also that the appellate procedure employed makes it desirable for exercise of this Court's supervisory jurisdiction.

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[10]This is particularly true since the Fifth Circuit granted a rehearing en banc but then, after briefs had been submitted and even after oral argument had been held, vacated the rehearing en banc, sending the case back to the original panel which then remanded it to the lower court (a procedure that makes the expense of such litigation virtually prohibitive to an individual who is made a defendant).

VIII. CONCLUSION

For the foregoing reasons, petitioners respectfully urge that, because of conflict with principles enunciated by this Court and other circuit courts and the national importance in interpretation of the Federal Securities Laws, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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COMPARISON OF PARTICIPATING PROVISIONS

Great States Policy

"The proportion of the divisible surplus accruing upon this policy shall be ascertained annually by the Company. Beginning at the end of the second policy year, and on each anniversary thereafter, such surplus as shall have been apportioned by the Company to this policy shall be available under any one of the following options, upon written request by the person having control of this policy: (1) applied toward payment of renewal premiums; or (2) applied to purchase participating paid-up additional insurance payable under the same terms and conditions as this policy; or (3) left with the Company to accumulate at interest at a rate of not less than 2½% per annum compounded annually; or (4) paid in cash. Outstanding dividend accumulations may be withdrawn in cash or shall be payable at the maturity of this policy to the person or persons entitled to its proceeds. If no option is selected, such divisible surplus will be paid in cash."

Huebner & Black Sample Policy

Upon payment of the premium for the full second policy year, and thereafter at the end of the second and each later policy year, this Policy, while in force other than as Extended Insurance, will be credited with such share of the divisible surplus, if any, as may be apportioned to it by the Company as a dividend. At the option of the payee, each dividend shall be applied under one of the following:

(1) CASH – Paid in cash.

(2) ACCUMULATION – Left with the Company, subject to withdrawal, to accumulate at interest, credited annually, at the rate declared by the Company but not less than 2¾%, but with no interest allowed for any fraction of a policy year.

(3) PREMIUM PAYMENT – Applied on a premium due on this Policy.

(4) PAID-UP ADDITION – Converted into a participating paid-up addition to the sum insured under this Policy. Any such additions outstanding may at any time be surrendered to the Company for cash in an amount equal to their reserve.

Unless the Company is otherwise directed in writing within 31 days after a dividend becomes payable, that dividend will purchase a paid-up addition under option (4). (As an alternative, some companies provide for automatic payment in cash if there is no other direction.)

(For ease of comparison, the main comparable language is underlined.)

EXHIBIT A

PRINCIPAL STATUTES AND RULES INVOLVED

Section 2 (1) of the 1933 Act (15 U.S.C. 77b (1)) —

"Sec. 2. When used in this title, unless the context otherwise requires —

" (1) The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

Section 3 (a) (8) of the 1933 Act (15 U.S.C. 77c (a) (8)) —

"Sec. 3 (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

* * *

" (8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia;"

Section 3 (a) (10) of the 1934 Act (15 U.S.C. 78c (a) (10)) —

"Sec. 3 (a) When used in this title, unless the context otherwise requires —

* * *

"(10) The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

Section 10 (b) of the 1934 Act, 15 U.S.C. 78j (b) —

"Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

* * *

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 of the Securities and Exchange Commission —

"Reg. §240.10b-5. It shall be unlawful for any person, directly or indirectly, by the use of any means or instru-

mentality of interstate commerce, or of the mails, or of any facility of any national securities exchange —

"(a) to employ any device, scheme, or artifice to defraud,

"(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." [Adopted in Release No. 34-3230, May 21, 1942, 13 F.R. 8177.]

McCarran-Ferguson Act, 15 U.S.C. 1012 —

"(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

"(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided,* That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1944, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law."

Illinois Revised Statutes, Sec. 845 of Insurance Code —

"After the calendar year during which this code becomes effective, no Life company authorized to do business in this

State shall issue both participating and non-participating policies unless at least 90 percentum of the profits on its participating policies shall inure to the benefit of the participating policy-holders. Any company having in force both participating and non-participating policies shall keep a separate accounting for each class of business and shall make and include in the annual statement to be filed with the Director each year, a separate statement showing the gains, losses, and expenses properly attributable to each of such classes and also showing the manner in which any general outlay of expense of the company has been apportioned to each except that this provision shall not apply to any company in which 90 percentum or more of the business in force is either participating or non-participating. This section shall not apply to business done by such Life company outside this State, nor to paid-up, or temporary insurance or pure endowment benefits issued or granted pursuant to the non-forfeiture provision prescribed in Clause (g) of Sub-Section (1) of Section 2241 nor to annuities or policies of re-insurance." As amended by Act approved June 13, 1957.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 75-3061

D. C. Docket No. CA 69-452

CHARLES L. GRAINGER, ET AL.,
Plaintiffs-Appellants,

versus

STATE SECURITY LIFE INSURANCE COMPANY, ET AL.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Alabama

Before GODBOLD, McCREE* and TJOFLAT, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Alabama, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed in part and vacated in part, and that this cause be and the same is hereby remanded to the said District Court for further proceedings in accordance with the opinion of this Court;

It is further ordered that defendants-appellees pay to plaintiffs-appellants, the costs on appeal to be taxed by the Clerk of this Court.

February 18, 1977

Issued as Mandate:

*Of the Sixth Circuit, sitting by designation.

CORRECTED

Charles S. GRAINGER et al., on behalf of themselves and all other similarly situated Purchasers of "Variable Investment Plan" Contracts Issued and Sold by Great States Life Insurance Company, Plaintiffs-Appellants,

v.

STATE SECURITY LIFE INSURANCE COMPANY et al., Defendants-Appellees.

No. 75-3061.

United States Court of Appeals, Fifth Circuit.

Feb. 18, 1977.

Appeal from the United States District Court for the Northern District of Alabama.

Before GODBOLD, McCREE,* and TJOFLAT, Circuit Judges.

GODBOLD, Circuit Judge:

This case involves the issue of whether contracts sold by an insurance company are "securities" for purposes of the Securities Acts of 1933 and 1934.[1] The district court held that as a matter of law the contracts were insurance and not securities and therefore were not within the purview of the Securities Acts, and entered a Rule 54(b) judgment for defendants. Also the court denied the request of plaintiffs to certify a class consisting of all purchasers of the contracts. We reverse the judgment for defendants and vacate the refusal to certify the class.[1a]

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*Of the Sixth Circuit, sitting by designation.

[1] 15 U.S.C. §§ 77a-78kk.

[1a] This is a companion case to *Hilgeman v. National Insurance Company of America*, (CA5, 1977) No. 75-1724, slip opinion p. ___, ___ F.2d ___, decided this date.

In the early 1960's Great States Insurance Company was marketing what it termed "Variable Investment Plan" contracts ("VIP contracts"). These contracts were, at least in form, similar to participating coupon policies.[2] The VIP contracts sold to plaintiffs allegedly incorporated as part of their terms a section of the Illinois insurance laws which required companies offering both participating and non-participating policies to keep separate accounts and to allocate 90% of their "profits" on their participating policies to the benefit of their participating policyholders.

Each named plaintiff purchased one or more VIP contracts. Later Great States adopted a drastically reduced scale of dividends on its VIP contracts. Plaintiffs brought a class action against State Security Life Insurance Company (the successor to Great States through a statutory merger), and L. M. Nimmo and Nimmo and Associates, Inc., as controlling persons of Great States, alleging: (a) violations of § 5 of the 1933 Act by the failure to register the VIP contracts; (b) violations of § 17 of the 1933 Act, and § 10(b) of the 1934 Act and Rule 10b-5 thereunder, 17 C.F.R.

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[2]A participating policy is "one in which dividends are paid to policyholders based upon company earnings, so that net cost is determined by deducting the amount of such dividends from the gross premiums." 1 J. Appleman & J. Appleman, Insurance Law and Practice, § 9 (1965).

The authors of this treatise go on to describe coupon policies in the following terms:

> "Coupon policies are usually considered to be nonparticipating in form, but, with the legal incidents usually attached thereto, they would seem properly to belong in the class of participating contracts. The rate is usually the same as for the latter group. The contract has inserted in it a sheet of coupons, one of which can be clipped each time a premium is paid. This may be sent to the company together with a remittance for the balance of the premium. The coupons often are graduated in amount, increasing in the same degree that ordinary dividends would increase, and interest is figured thereon at the company's regular rate.
>
> "Thus, it is usually considered that if the insured fails to clip such a coupon and instead sends the full amount of the premium to the company, he has elected to permit it to remain at interest, and no further action on his part is usually required."

Id. at § 10.

240.10b-5 (1976), in mailing material misrepresentations to buyers in connection with the sale of the VIP contracts; (c) common law fraud in connection with the sale of the VIP contracts; (d) breach of the VIP contract; and (e) violations of the anti-fraud and proxy provisions and rules of the 1934 Act and common law fraud, in connection with the 1968 merger between State Security and Great States.[3]

[1] Defendants filed motions to dismiss, to quash service of process and to block discovery. The court overruled the motion of State Security to dismiss the common law fraud and breach of contract claims against it. It also overruled all motions of defendants concerning the claims relating to the 1968 merger. The court granted the motions of Nimmo and Nimmo and Associates to dismiss the common law fraud and breach of contract claims stemming from the sale of the VIP contracts. None of these rulings have been appealed. Two rulings which the court made are now before us. First, it dismissed all federal Securities Act claims arising out of the sale of the VIP contracts against all three defendants on the ground that the contracts were not covered by the Acts because they were insurance contracts, and thus the plaintiffs had failed to state a claim upon which relief could be granted. The court, under Rule 54 (b), directed entry of judgment for the defendants on these federal Securities Acts claims. The court also denied plaintiffs' motion to certify a class consisting of VIP contract holders.[4]

[2] Generally, conventional life insurance policies are not securities for purposes of the federal Securities Acts. This view is supported by the legislative history of the 1933

[3]At least one of the plaintiffs was also a shareholder of Great States.

[4]The class determination is appealable under the general rule that "interlocutory orders from which no appeal lies are merged into the final judgment and open to review on appeal from that judgment." *Monarch Asphalt Sales Co., Inc. v. Wilshire Oil Co.*, 511 F.2d 1073, 1077 (CA10, 1975); 7A Wright & Miller, Federal Practice & Procedure § 1802 at 270 (1972).

Act,[5] by the leading commentators in the securities law field, L. Loss, *Securities Regulation*, 496-501 (1961); 2 A. Bromberg, *Securities Law: Fraud* § 6.5(1) n. 92 at 134 (1968); and by dictum in the Supreme Court's decision in *Tcherepnin v. Knight*, 389 U.S. 332, 88 S.Ct. 548, 19 L.Ed. 2d 564 (1967).[6]

However, as Professor Loss has noted, the concept of insurance is really a continuum ranging from one year term insurance, which is clearly pure insurance, through variable annuities to mutual fund shares and common stocks, which are equally clearly securities. L. Loss, *Securities Regulation* 2534 (1969 Supp.). Thus, various items which have usually been denominated "insurance" have been found to be "securities" for purposes of the federal Securities Acts. For example, in *S.E.C. v. United Benefit Life Insurance Company,* 387 U.S. 202, 87 S.Ct. 1557, 18 L.Ed.2d 673 (1967), and *S.E.C. v. Variable Annuity Life Insurance Company,* 359 U.S. 65, 79 S.Ct. 618, 3 L.Ed.2d 640 (1959), the Supreme Court held that flexible fund or variable annuities are securities and are therefore subject to the provisions of the Securities Acts.[7]

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[5]In the House Report on the 1933 Act it was clearly stated that ". . . insurance policies are not to be regarded as securities subject to the provisions of the act." HR Rep. No. 85, 73rd Cong., 1st Sess. 15 (1933).

[6]In *Tcherepnin* the Court pointed out that Congress had specifically stated that " 'insurance policies are not to be regarded as securities subject to the provisions of the act . . and the exemption from registration for insurance policies was clearly supererogation.' " 389 U.S. at 342-43, n. 30, 88 S.Ct. at 556, 19 L.Ed.2d at 572-73, n. 30 [cites omitted].

Justice Brennan, in his concurring opinion in *S.E.C. v. Variable Annuity Life Ins. Co.,* 359 U.S. 65, 79 S.Ct. 618, 3 L.Ed.2d 640 (1959), made virtually the same point when he said that "[u]nder the Securities Act, it would appear that in the case of the ordinary insurance policy, the exemption would be just comfirmatory of the policy's noncoverage under the definition of security." 359 U.S. at 74, n. 4, 79 S.Ct. at 623, 3 L.Ed.2d at 646, n. 4 [cites omitted].

[7]More recently the Securities and Exchange Commission has ruled that variable death benefit life insurance policies are also "securities." Securities Act Release No. 33-5360 Fed.Sec.L.Rep. [1972-73 Decisions] ¶ 79,207.

[3] The court below compared the VIP contracts with the policies involved in *Variable Annuity* and *United Benefit* and found the VIP contracts different because they provided for what the court termed a "significant" fixed death benefit of $10,000. The comparison of policies was proper, but the court could not stop at this point. In making a determination of what exactly was being offered by the Great States salesmen it was required to consider the methods used in selling the contracts.

In *S.E.C. v. Joiner Leasing Corp.*, 320 U.S. 344, 64 S.Ct. 120, 88 L.Ed. 88 (1943) the Court held that in determining if an instrument is an investment contract, and therefore a security, "the terms of offer, the plan of distribution and the economic inducements held out to the prospect" were all relevant factors to be considered. 320 U.S. at 353, 64 S.Ct. at 124, 88 L.Ed. at 94. The Court went on to say that "[i]n the enforcement of an Act such as [the 1933 Act] it is not inappropriate that promoters' offerings be judged *as being what they were represented to be*." *Id.* [emphasis added]. Numerous lower courts have correctly interpreted this language from *Joiner* as justifying a consideration of advertising and promotional efforts in ascertaining that items which intuitively would not seem to be securities are, in reality, securities within the meaning of the federal Acts, *e. g., Miller v. Central Chinchilla Group, Inc.,* 494 F.2d 414, 417 (CA8, 1974) (chinchillas); *Glen-Arden Commodities, Inc. v. Costantino,* 493 F.2d 1027, 1034-35 (CA2, 1974) (Scotch whisky receipts); *S.E.C. v. Brigadoon Scotch Distributors, Ltd.,* 388 F.Supp. 1288, 1290 (S.D. N.Y., 1975) (rare coins); *S.E.C. v. Haffenden-Rimar,* 362 F.Supp. 323, 325 (E.D.Va., 1973), *aff'd* 496 F.2d 1192 (CA4, 1974) (Scotch whisky). Indeed, the Supreme Court itself in *United Benefit* examined the advertising used to sell the "policies" at issue in making its determination that

the appellee was selling investment contracts and not insurance.[8]

[4] While the district court recognized the authority of *Joiner* and the subsequent "advertising" cases, it attempted to limit their scope by formulating a rule that advertising and promotional efforts can be used to determine the character of an instrument only where that instrument is not clear on its face. In essence, the district court read into the Securities Acts a parol evidence rule. We think that interpretation cannot be sustained. First, neither *Joiner* nor any of the lower court "advertising" cases (with one possible exception) make use of the parol evidence rule in determining whether an item is a security.[9] More important, however, use of a parol evidence rule leads a court to focus on the wrong question. The proper question before the district court was not "what is the correct interpretation of the VIP contracts?" but "what were defendants purporting to sell to plaintiffs?"[10] The parol evidence rule may have some application to the former question. It is not relevant to the latter question.[11] Therefore, the district court must

[8]Speaking for a unanimous Court Justice Harlan noted that,

> "United's primary advertisement for the 'Flexible Fund' was headed 'New Opportunity for Financial Growth.' United's sales aid kit included displays emphasizing the possibility of investment return and the experience of United's management in professional investing."

387 U.S. at 211, n. 15, 87 S.Ct. at 1562, 18 L.Ed. at 679, n. 15.

[9]The district court cited *Chapman v. Rudd Paint & Varnish*, 409 F.2d 635 (CA9, 1969), as authority for its use of the parol evidence rule. However, the language in *Chapman* concerning the consideration of promotional advertising is *dicta*, for the Ninth Circuit did in fact examine the relevant advertising material in making a determination that a franchise arrangement was not a security.

[10]*Cf. Goodman v. H. Hentz & Co.*, 265 F.Supp. 440, 444 (N.D.Ill., 1967) where sale of nonexistent securities was held to violate Rule 10b-5.

[11]Even if we were to hold that the parol evidence rule applied in the case before us, it still by its own terms would not operate to bar evidence of the oral representations made by Great States salesmen. First, plaintiffs' 10b-5 cause of action is a fraud-based cause of action. *Cf. Ernst and Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). Tradi-

in making a determination of whether the VIP contracts were securities take into account all the circumstances attending the sale of the VIP contracts, including the provision of Illinois law allegedly incorporated into the contract.

[5] We also have substantial doubts about the significance which the district court attributed to the death benefit on the VIP contracts. The mere presence of a death benefit of $10,000, or for that matter any given dollar amount, cannot conclusively establish that the insurance features of a particular contract are not simply window dressing on what is essentially an investment contract. Consideration must be given not only to the amount of the death benefit but also to the relationship between the size of the death benefit and the size of "premium" payments. A showing that the "premiums" were disproportionately high (in terms of insurance industry norms) in relation to the amount of the death benefit would be persuasive evidence that the VIP contracts were not being bought and sold for their insurance features, *i. e.*, as insurance policies, but for their future "dividends," *i. e.*, as investment contracts.[12]

[6] The district court held that class action was not appropriate on the VIP contract fraud claims because the claims depended upon the particularized representations made to each class member. It is true that a class action is

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tionally, the parol evidence rule will not operate to exclude parol evidence introduced to show fraud. Restatement of Contracts § 238 (b), (1932). Moreover, many of the words in the VIP contracts such as "dividend" and "investment" possess a variety of meanings, and, generally speaking, parol evidence is admissible for the purpose of interpreting ambiguous language in contracts. *Id.* at § 233.

[12]Data on premium/death benefit ratios in participating life policies can be found. For example, such data was gathered by the SEC in formulating its now-rescinded Rule 3c-4 and incorporated therein in the form of a minimum multiple scale. We do not express any view on the substance of that no longer operational rule. We mention it merely to point out the availability of relevant data.

usually inappropriate in a securities fraud case where oral misrepresentations are involved. As we said in *Simon v. Merrill Lynch, Pierce, Fenner and Smith,* 482 F.2d 880 at 882 (CA5, 1973):

> If there is any material variation in the representations made or in the degrees of reliance thereupon, a fraud case may be unsuited for treatment as a class action. *See* Rule 23. Advisory Committee's Official Note, 39 F.R.D. 98, 107 (1966). Thus, courts usually hold that an action based substantially, as here, on oral rather than written misrepresentations cannot be maintained as a class action.

However, as this quote indicates, the key concept in determining the propriety of class action treatment is the existence or nonexistence of material variations in the alleged misrepresentations. It is possible, although unlikely, that oral misrepresentations can be uniform, *e. g.*, through use of a standardized sales pitch by all the company's salesmen. Plaintiffs in the present case should be given the opportunity to demonstrate the existence and use of such a device. If plaintiffs cannot do this, then the district court may quite properly refuse to certify a class on the grounds that common questions of law or fact do not predominate.

We therefore vacate the denial of class status to VIP contract holders.

REVERSED in part, VACATED in part, and REMANDED for further proceedings.

Charles S. GRAINGER et al.,
Plaintiffs-Appellants,
v.
STATE SECURITY LIFE INSURANCE
COMPANY et al.,
Defendants-Appellees.

No. 75-3061.

United States Court of Appeals, Fifth Circuit.

Nov. 17, 1977.

Appeal from the United States District Court for the Northern District of Alabama.

Before BROWN, Chief Judge, and THORNBERRY, COLEMAN, GOLDBERG, AINSWORTH, GODBOLD, MORGAN, CLARK, RONEY, GEE, TJOFLAT, HILL and FAY, Circuit Judges.

BY THE COURT:

IT IS ORDERED by the court that the order entered on May 25, 1977, 5 Cir., 553 F.2d 1008, for a rehearing of this case en banc is hereby vacated, and the case is remanded to the panel.

JAMES C. HILL, Circuit Judge, dissenting.

ON PETITION FOR REHEARING

Before GODBOLD and TJOFLAT, Circuit Judges.*

PER CURIAM:

In their petition for rehearing appellees L. W. Nimmo and Nimmo & Associates, Inc., protest that our decision means that an endowment insurance policy containing what they describe as "a commonly used provision" for the pol-

*Former Circuit Judge McCree, a member of the original panel, did not participate in this decision.

icyholder's participating in surplus can be found to be a security by reason of methods used in its sale. This characterization of our decision is not correct. We did not hold that participating life insurance policies in general are securities or even that the particular contracts in this case are securities. What we have held is that the district court must consider, along with the provisions of the VIP contracts themselves, the totality of the circumstances surrounding their sale, including any oral representations made, in determining whether defendants were selling securities.

"Endowment policies" vary in their terms and provisions, and participation clauses differ also. In this instance, as pointed out in our opinion the contract in issue is named "Variable *Investment* Plan" (emphasis added). It purports to guarantee the purchaser "90% of divisible surplus earnings." Attached coupons physically resemble coupons often attached to bonds. Also, without indicating any views on the relationship between the size of the death benefit and the size of premium payments in the VIP contracts, we pointed out that this relationship is a proper factor for consideration by the district court (as opposed to the substantiality of the death benefit, considered in isolation) in determining whether the facial characteristics of the contracts plus the circumstances of their sale caused them to be securities.

The petition for rehearing is DENIED.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 75-3061

CHARLES S. GRAINGER, ET AL.,
Plaintiffs-Appellants,

versus

STATE SECURITY LIFE INSURANCE
COMPANY, ET AL.,
Defendants-Appellees.

Appeal from the United States District Court for the
Northern District of Alabama

(Filed December 12, 1977)

Before BROWN, Chief Judge and THORNBERRY, COLEMAN, GOLDBERG, AINSWORTH, GODBOLD, MORGAN, CLARK, RONEY, GEE, TJOFLAT, HILL, and FAY, Circuit Judges.

BY THE COURT:

IT IS ORDERED that the petition for reconsideration of vacation of rehearing en banc filed by appellees, Leslie W. Nimmo and Nimmo and Associates, Inc., is DENIED.

ENTERED FOR THE COURT:

/s/ JOHN C. GODBOLD

UNITED STATES CIRCUIT JUDGE

In the United States District Court for the Northern District of Alabama, Southern Division

Charles S. Grainger, et al., *Plaintiffs.*	)	
vs.	)	Civil Action No. 69-452
State Security Life Insurance Company, et al., *Defendants.*	)	

ORDER

(Filed June 20, 1972)

The above-styled cause is presently under submission on the following motions filed in behalf of the respective parties hereto: (1) motion of defendant, State Security Life Insurance Co., to dismiss the complaint; (2) motions of defendants, L. W. Nimmo and Nimmo & Associates, Inc., to quash service of process or in the alternative to dismiss the complaint; (3) motion of defendant, State Security Life Insurance Co., to require plaintiffs to post security for costs; (4) motion of plaintiffs for an order determining that this suit may be maintained as a class action; and (5) motion of plaintiffs for an order requiring production of documents by defendants.

In the exercise of its discretion, the Court elects to treat the motion to dismiss filed in behalf of each defendant as a motion for summary judgment and to allow all parties 20 days from the date of this order within which to submit any affidavits or other documentary evidence which they may deem relevant to the disposition of the following issue:

whether the "Variable Investment Plan" contracts issued to plaintiffs by Great States Life Insurance Co. or its successor in interest, State Security Life Insurance Co., constitute "securities" within the ambit of § 2 (1) of the Securities Act of 1933, 15 U.S.C.A. § 77 (b) (1) (1971) or § 3 (10) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78 (c) (10) (1971).

All motions other than defendants' motions to dismiss will remain under submission pending resolution of the question raised on motion for summary judgment.

It is so ordered.

Done this 20th day of June, 1972.

SEYBOURN H. LYNNE
Chief Judge

ORDER*

(Filed June 5, 1975)

This cause has been before this Court on motions to dismiss, to quash, and for summary judgment. The Court has had the benefit of extensive briefs and learned oral arguments from counsel.

* (Note to judgment of District Court: This action was brought as a two-fold complaint. The first counts are based on the sale of the participating life insurance policies issued by Great States Insurance Company. The latter counts are based on an allegedly misleading proxy statement issued by State Security Life Insurance Company, successor to Great States by a merger and which plaintiffs' claim was controlled by Mr. Nimmo. The District Court found that Mr. Nimmo was not in control of State Security nor was he a participant in any securities law violation (A-52-3); but it held that the claim of plaintiffs based on an alleged conspiracy was not subject to motion to dismiss. No final judgment was entered nor appeal taken from the order on these latter counts, which are discussed in Parts IIB and VB of the following memorandum opinion. Consequently, that part of the action was not before the Fifth Circuit and would not be brought before this Court for review.)

Upon consideration of the analyses of counsel, the Court is of the opinion that the attached memorandum prepared by its law clerk, E. Mabry Rogers, correctly states both the law and the facts on this complex action, and the Court wholly adopts it as its opinion. In conformity with such memorandum, which the Court deems to be of obviously superior quality in its exhaustive and analytical discussion of subtle issues advanced by ingenious counsel,

It is Ordered, Adjudged and Decreed by the Court that

(a) Plaintiffs' claims against all defendants based upon the theory that the "V.I.P." contracts are "securities" (Counts 1, 2, and 3 of the complaint), be and the same are hereby dismissed for failure to state a claim under the Securities Exchange Act of 1934, the Securities Act of 1933, or the Securities Act of Alabama. There is no just reason for delay in entering a final judgment as to this claim, so that the Clerk is hereby Ordered to enter final judgment hereon pursuant to F.R.Civ.P. 54 (b);

(b) Defendant State Security's motion to dismiss the breach of contract and common law fraud claims (Counts 4, 5, and 6 of the complaint), is overruled insofar as the simple failure to state a claim is involved;

(c) The motions of defendants Nimmo and Nimmo and Associates, Inc., to dismiss the common law fraud and breach of contract claims as to the "V.I.P." contracts are granted for failure to state a claim as to these defendants;

(d) The motions of all defendants to dismiss the counts alleging fraud, both of the common law and of the federal statutory varieties as to the 1968 merger, are overruled;

(e) The motions of defendants Nimmo and Nimmo and Associates, Inc., to quash as to the counts concerning the 1968 merger are overruled; and

(f) The motion of plaintiffs to certify a class as to the "V.I.P." contracts is overruled, since the common questions

of law do not predominate over the questions affecting individual members only. The Court reserves a ruling on the class allegations regarding the 1968 merger and requests counsel to develop the issue in due course.

Done this 5th day of June, 1975.

SEYBOURN H. LYNNE
Senior Judge

MEMORANDUM

(Filed June 5, 1975)

TO: Judge Seybourn H. Lynne

FROM: E. Mabry Rogers, Law Clerk

RE: Grainger v. State Security Life Insurance Co., Civil Action No. 69-452, Pending Motions

I. PROCEEDINGS TO DATE.

On July 15, 1969, plaintiffs instituted this action on behalf of themselves and of the classes they purported to represent. In their complaint, they allege five basic causes of action:[1]

> (1) That defendant State Security Life Insurance Company ("State Security") conspired with defendants L. W. Nimmo ("Nimmo") and his corporation, Nimmo & Associates, Inc. ("Nimmo Inc."), to defraud Great States Life Insurance Co. ("Great States") and its public, minority shareholders by a scheme and conspiracy whereby Nimmo agreed to sell his stock, and the stock held by Nimmo, Inc., of Great States at a price far in excess of its market value (or book value) to State Security on the understanding that State Se-

[1]This characterization of the complaint is taken from the brief filed herein by plaintiffs on November 4, 1969.

curity would then be caused to merge with Great States. Thereby Great States and its minority shareholders would be obligated to assume the debt incurred to buy out Nimmo and Nimmo Inc. The cause of action here is predicated upon the Securities Exchange Act of 1934 ("1934 Act") and on Rule 10b-5 thereunder;

(2) Misrepresentations were made to purchasers of "V.I.P." contracts issued by Great States (and thereafter assumed by State Security pursuant to the merger), each of which contracts was a "security" as defined by federal law, either on its face or because of representations made to the buyers. This cause of action is predicated upon § 17 (a) of the Securities Act of 1933 ("1933 Act"), § 10 (b) of the 1934 Act, Rule 10b-5 thereunder, and upon the Alabama Securities Act, Tit. 53 §§ 28, 45, *Code of Alabama 1940* (Recomp. 1958) (1973 Cum. Supp.);

(3) The "V.I.P." contracts were not registered with the SEC prior to being offered to the public, as required by the 1933 Act;

(4) Assets of Great States were allegedly unlawfully diverted to Nimmo for his private benefit, to the damage of Great States stockholders and to the holders of Great States "V.I.P." contracts, a common law cause of action; and

(5) The defendants have breached the terms of the "V.I.P." contracts held by plaintiffs and are due to account for same.

Service of the complaint was accomplished upon State Security through the Superintendent of Insurance for Alabama. Service upon Nimmo and upon Nimmo, Inc., was accomplished by the United States Marshal in Springfield, Illinois.

On September 5, 1969, State Security filed two motions, a motion to dismiss, based upon 57 grounds, and a motion to require plaintiffs to post security for costs.

On September 29, 1969, Nimmo moved to dismiss or, alternatively, to quash service. Nimmo, Inc., filed a similar motion on the same date.

On September 30, 1969, plaintiffs filed a motion seeking production of various documents by the defendants.

On January 15, 1970, plaintiffs filed a motion for determination of both classes and for notice to the classes so determined.

On June 20, 1972, following disposition of the case of *Hilgeman v. Nat'l Ins. Co. of America,* 444 F.2d 446 (5th Cir. 1971), this Court entered an order treating the defendants' motions to dismiss as motions for summary judgment, and requesting counsel to direct their submissions to the disposition of the following issue:

> Whether the "Variable Investment Plan" contracts issued to plaintiffs by Great States Life Insurance Co. or its successor in interest, State Security Life Insurance Co., constitute "securities" within the ambit of § 2 (1) of the Securities Act of 1933, 15 U.S.C.A. § 77 (b) (1) (1971) or § 3 (1) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78 (c) (10) (1971).

All other motions were held in abeyance pending resolution of the issue above.

On September 5, 1974, the Court heard additional arguments directed to this issue.

On September 23, 1974, plaintiffs filed a motion for summary judgment in their behalf as to Counts 1 through 6. These counts encompass the claims as to fraud in the sale of the "V.I.P." contracts as securities and as to breach of the "V.I.P." contract itself.

In connection with the above proceedings, the Court has received affidavits from L. W. Nimmo (October 23, 1969),

Richard V. Moore, President of State Security (July 27, 1972), Lawrence A. Wadsworth, plaintiff (July 31, 1972), Charles S. Grainger, plaintiff (July 31, 1972), and James Williams Parsons, plaintiff (August 3, 1972). In addition, a transcript of the testimony of Marvin Henson, Jr., a plaintiff in this action who died on December 31, 1971, has been received (August 3, 1972). Moreover, depositions and documentary evidence have been received.

The Court has also had the benefit of numerous briefs of counsel in this case, the most recent of which include plaintiffs' brief of September 23, 1974, directed to the issue outlined above, and the reply brief from Nimmo and Nimmo Inc., of November 29, 1974.

Plaintiffs contend that because the "V.I.P." contracts were "securities" under the relevant federal securities provisions, jurisdiction and venue are good as to all defendants here. Additionally, they argue that because Nimmo and Nimmo Inc. were "controlling persons" of Great States at the time of its merger into State Security, jurisdiction as to them is also good under the 1934 Act.

The defendants, Nimmo and his company, argue that they were not "controlling persons" at the time of the merger, so that jurisdiction under the 1934 Act does not lie. Moreover, Nimmo and his company argue that the "V.I.P." contracts were not "securities" and that jurisdiction under the 1933 and 1934 Acts is therefore likewise defeated.

These matters are more appropriately resolved on motions for summary judgment rather than upon preliminary motions, since the intertwining of the merits with the jurisdictional issues warrants the consideration of more evidence than is usually appropriate to motions to dismiss.

II. UNDERLYING FACTS.[2]

A. The "V.I.P." Contracts.

In September, 1962, plaintiff Grainger was approached by two agents who are presumed to have been employed by Great States about purchasing a V.I.P. contract. They told him that they were selling an investment, not insurance. He was told that Great States would pay him and other buyers 90 per cent of the profits from the company. Grainger purchased, then and later, two and one-quarter "units"[3] from the salesmen.

Plaintiff Wadsworth bought his contract in October 1962. He was told

> that it was an "investment," that it would send my son through high school and college and pay all his expenses, that after he finished college it would pay him the income, that after the first few years the policy would take care of itself, and in case of my son's death, it would also pay $10,000.00 plus everything I had paid on it up to that point.

Plaintiff Henson, who is now deceased, was approached in September, 1962, about buying the contracts. He was specifically told that it was not insurance but was an investment on which he could make as much as 40 per cent interest.

Plaintiff Parsons was contacted in early 1963 about the purchase of an "investment policy" for his three-year-old son. He was given much the same glowing account of the dividend rate on his policy as were the other plaintiffs.

Each plaintiff received a similar "V.I.P." contract, a copy of which is in the record now before the Court.

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[2]These facts have been garnered from all submissions by all parties to date. Where relevant, differences in the submissions are noted.

[3]Grainger's affidavit states that "$10,000.00 is one unit," but this apparently refers to the face value of the insurance contract, not to its purchase price.

The contracts begin

> Great States Life Insurance Company of Quincy, Illinois, will pay the sum insured under the conditions hereof to the insured on the maturity date, if then living, provided all coupons hereon have been left with the company to accumulate at interest. Etc.

Mr. Grainger's contract shows a face-amount of $10,000.00, premium amount of $401.52, payable for ten years, and a maturity date of November 13, 1987. This kind of policy is characterized by State Security as an "Ordinary Life Coupon, Participating 25 Year Endowment Option with Coupon, Reduced Premium After 25 Years" policy. Its provisions will be developed more fully, *infra*.

Two particular features of the policy deserve mention here, however: The 90 per cent participation feature and the coupon feature.

As a part of the policy received by each plaintiff,[4] there was an excerpt from Illinois law which provided that

> No Life company . . . shall issue both participating and non-participating policies unless at least *90 percentum* of the profits on its participating policies shall *inure to the benefit* of the participating policy-holders. Any company having in force both participating and non-participating policies *shall keep a* separate accounting for each class of business. . . . [emphasis supplied, in part].[5]

According to Charles E. Miller, Manager of Great States in Alabama during the relevant period, this excerpt was included in the sales presentation made in connection with

[4]Interestingly enough, neither of the "sample" policies tendered with affidavits submitted by the defendants contained this excerpt from the Illinois statutes.

[5]Although the law applied only to Illinois corporations, it was made a part of the contract by language to the effect that "V.I.P." policies in any state would be governed by the section.

the offer and sale of "V.I.P." contracts and was attached to every such contract sold in Alabama.

Also attached to the policies were twenty-four "Guaranteed Premium Reduction Coupons." These coupons guaranteed payment of stated amounts of cash by Great States to the insured upon surrender of the coupon. Provisions were also made for other, more attractive benefits, if the coupons were retained.

Additional evidence before the Court shows that Great States adopted, on August 28, 1962,[6] a dividend schedule which apparently approximated — very roughly[7] — a payout of 90 per cent of the company's profits on these policies. On July 1, 1966, a new dividend scale was proposed, and apparently accepted by Great States, distributing "about 50 per cent" of the profits to "V.I.P." contract holders. Rathbone Ltr., July 1, 1966. The actuary explained that this dividend change occurred because "[d]ividends for the early years were estimated rather high to attract new policy owners. Now that experience and cost for this block of business has been developed, a long-range dividend schedule is possible." Rathbone Ltr., March 16, 1967.

In a form letter sent to "V.I.P." policyholders who inquired about the dividend reduction, Great States explained that "[t]he reduction of this year's dividends for this policy series was recommended by our consulting actuaries and is

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[6]This was just prior to the purchases made by the named plaintiffs in this action.

[7]The evidence indicates that the Great States actuary constructed a dividend schedule which utilized "practically all the profits that might be expected from this contract . . . [leaving] little, if anything, for the stockholders." Tiffany Ltr., June 19, 1962. At the August 28, 1962, meeting of the Great States Board of Directors, Nimmo moved that dividends be set at the rate of 10 per cent below that suggested above. This may be viewed as a rough attempt at complying with the Illinois law cited as a part of the "V.I.P." contract, but it certainly does not seem to be an attempt to determine the 90 per cent payout by means of carefully segregated accounting entries, as required by that law.

due to an increased mortality experience along with the ever increasing costs of operations." The letter went on to report that "the dividend scale will increase in the years ahead."

In addition, the minutes of the Great States Board meeting of December 21, 1962, show a report "that the Alabama Commissioner [of Insurance] had instructed us [*i.e.*, Great States] to cease selling the VIP policy in that state." No apparent action was taken on this instruction. On August 1, 1963, the Commissioner, in a letter to Great States, requested that a representative from the company meet with the Commissioner, since policies of "a profit-sharing or investment nature" had not been approved for sale in Alabama. The results of this meeting do not appear.

It is apparent, however, from testimony taken in the case of *Henson v. State Security Life Ins. Co.*,[8] that the Commissioner, as late as August of 1967, had done little or nothing to contact holders of "V.I.P." policies regarding any action he had taken against Great States or its successor, State Security.

At present, State Security maintains a statutory reserve for the payment of benefits and obligations due under the V.I.P. policies. It does not, however, maintain separate accounting entries which make readily available the amount of profits derived from the V.I.P. contracts.[9]

B. The Merger.

From the time of its organization as an Illinois company in 1959, until August 31, 1968, Nimmo was formally and

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[8]The trial court directed a verdict on statute of limitations grounds. He was reversed in part, 288 Ala. 497, 262 So. 2d 745 (1972).

[9]This information is taken from plaintiffs' brief of September 23, 1974. For some reason, the answers to interrogatories which would show this information have apparently not been filed with the Court. *See F.R.Civ.P.* 5(d).

in fact active in the management of Great States. At all times prior to its merger into State Security, Nimmo and his company owned the controlling interest in Great States.

On June 13, 1967, Nimmo and Nimmo Inc., of which Nimmo was a 90 per cent shareholder, agreed to sell their controlling interest in Great States to State Security. The sale was of 763,049 shares of the 1,150,000 outstanding shares of Great States at a gross price of $2,098,384.75.[10] In return, Nimmo and his company agreed to deliver not only their stock, but also the written resignations of those members of the Great States Board of Directors requested by State Security. Moreover, Nimmo and his company promised that "[t]he Board of Directors of Great States [and another company not the subject of this lawsuit] prior to the closing of [the] Agreement shall execute an agreement of merger with Security and will further call a meeting of the respective shareholders of Great States [and the other company] to be held for the purpose of approving said agreement of merger."

On July 20, 1967, State Security wrote to Nimmo proposing to terminate the above agreement. Nimmo agreed to the termination.

On November 6, 1967, State Security filed a lawsuit against Nimmo and his company charging that the July 20, 1967, letter was a sham requested by Nimmo "to avoid appearing precommitted to a merger when dealing with the boards of directors of the companies involved." The complaint alleged that, despite the termination letter, Nimmo had agreed to effectuate the June 13, 1967, agreement. The

[10]The purchase price was broken down into separate components: $270,000.00 for the 54,000 shares held by Nimmo Inc., or $5.00 per share; $1,828,384.75 for the 709,049 shares held by Nimmo, or approximately $2.60 per share.

suit was therefore predicated upon breach of the June agreement and upon fraud in its July recission.[11]

On May 10, 1968, State Security again contracted with Nimmo and Nimmo, Inc., to buy the 763,049 shares of Great States owned by them. The purchase price was now enhanced to $2,348,200.00.[12] Nimmo's 709,049 shares were assigned a value of $2,078,200.00, or about $2.93 per share. Nimmo, Inc.'s 54,000 shares were again assigned a value of $270,000.00, or $5.00 per share. On May 10, 1968, the market price of Great States, according to the plaintiffs, was approximately $1.13 per share.[13]

As part of this agreement, State Security agreed to hire Nimmo as a consultant for $30,000.00. Moreover, State Security agreed to have its action against Nimmo dismissed with prejudice, and the agreement recited that this was a part of the consideration paid to obtain Nimmo's acceptance of the agreement.

Paragraph five of this agreement required Nimmo to deliver "on or before August 28, 1968," the resignations of such members of the Great States Board of Directors as State Security should direct.

This sale was financed through payment by State Security of $992,657.02, apparently from its own assets. The additional $1,357,342.98 was apparently raised by sale of, or by outright transfer to Nimmo of, assets belonging to Great

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[11]In his deposition, Nimmo has testified that 90 per cent of the allegations in this complaint were untrue.

[12]There was an additional $1,200.00 paid for 266 shares of the common stock of Lincoln Life Ins. Co. of Arizona.

[13]The proxy statement sent out by Great States to its shareholders, in preparation for a September 20, 1968, meeting, reported that the high bid for Great States stock in 1968 was $2.50, while the low bid was $1.00.

According to plaintiffs, the book value of Great States stock was $.94 per share, and the adjusted book value was $2.09 per share.

States.[14] How the $992,657.02 in cash was to be raised is unclear; it is inferable that the sales agreement required only that by August 28, 1968, State Security would deliver to Nimmo and his company $992,657.02. A subsequent agreement reveals that State Security, jointly with Dependable Life Insurance Company, an Alabama insurance company,[15] executed to Nimmo a note for $873,667.98. The implication is that Nimmo and his company therefore received $118,989.04 in cash on August 28, 1968.[16]

Following this agreement, Great States issued a Notice of Meeting of Stockholders and a Proxy Statement, under date of August 8, 1968. The notice was signed by Nimmo. It reported that the meeting was called to elect directors and transact other business. A natural inference from this notice is that this election was related to Nimmo's promise in the sales agreement to deliver the resignations of the then-governing Board of Great States.

There were seven men nominated for the seven available Board positions. Of these, at least four were employees or directors of State Security.[17] The connection of nominees, A. Lamar Reid, Charles Butz, and Everett W. McClure, does not appear, although Mr. Reid's law firm in Birmingham, Alabama, was serving "of counsel" for State Security as of November 6, 1967.

The proxy statement revealed Nimmo's controlling interest and his sale of that interest effective on August 28,

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[14]Paragraph 10 of the Sales Agreement. *See also* the Escrow Agreement, tendered as Plaintiffs' Exhibit 21 to the most recent briefs on summary judgment. *See also* fn. 18, *infra*.

[15]A merger of Dependable (of Mobile, Alabama) into State Security was approved by all involved shareholders as of August 12, 1968.

[16]The plaintiffs' statement that only $25,000.00 in cash was paid to Nimmo before August 28, 1968, seems to be in error. It is perhaps derived from the aborted agreement of June 13, 1967.

[17]The proxy statement revealed the connections of three of them to State Security. It did not show that nominee Wittenberg was a Director of State Security.

1968. It also included the sales agreement and the escrow agreement between State Security and Nimmo.

The statement directs its readers' attention to the sales agreement and states that it shows that

> The net cash payment for control stock of [Great States] will be approximately $1,500,000.00, which [State Security] has said it would borrow pending completion of a merger with [Great States].

It is difficult to discern how the sales agreement provides any such thing.[18]

The statement also announces State Security's intention to merge with Great States upon completion of the Nimmo sale. It then states, "[n]either L. W. Nimmo or Nimmo and Associates, Inc., is party to the proposed merger, nor has either party participated in the planning of such merger."

The notice established the meeting date as August 28, 1968, but it was not held until August 30, 1968, for un-

[18] *See* text accompanying Fn 14, *supra.*

This statement may be explained by combining the sale contract, the escrow agreement and the August 8 proxy statement. Under the sales agreement Nimmo was to have Great States sell, at stated minimum prices, the Great States office property, bonds of Putnam Dye Co., stock of the Horace Mann Life Ins. Co., and stock of the Life Assurance Co. of the West. If the minimum disposition prices of these assets are added to the amount State Security was to pay the escrow agent – $992,657.02 – the total equals the sales price of $2,350,000.00. On page 5 of the August 8 proxy statement, it is reported that Great States had disposed of the Horace Mann stock. If the contract minimum for this stock – $507,675.00 – is added to the amount State Security was to pay the escrow agent, the total is "approximately $1,500,000.00."

If this is the correct explanation of the transactions involved, it seems clear that part of the consideration paid Nimmo reflected these properties; in a sense they were transferred to him at the stated values. Since the values stated in the sales contract were inflated (Nimmo's Deposition, p. 127), Nimmo actually received less for his shares than is reflected in the raw sales price.

Regardless of the explanation of the above figures, plaintiffs have not complained about them nor do plaintiffs indicate how such figures may relate to their alleged causes of action.

explained reasons.[19] Immediately thereafter, the new Board met and adopted an agreement of merger between Great States and State Security, dated August 28, 1968.

Curiously enough, this agreement was signed for Great States by A. Lamar Reid, as President, although he was not elected President until August 30, 1968. In fact, on the date of the agreement, Nimmo, according to his affidavit filed herein, was still a director of Great States.

On August 28, 1968, A. Lamar Reid, as President of Great States,[20] issued a notice of a special meeting of the shareholders of Great States to be held on September 20, 1968. This meeting was called to vote upon the merger agreement between Great States and State Security. The proposed merger provided for an exchange of the stock of Great States for that of State Security at a ratio of 1.5 to 1. Great States management recommended, on page two, that the merger be approved; on page one, it was stated that the present Great States management "are persons nominated by Security. . . ."

This merger was approved by the shareholders, and the merger was consummated.

Plaintiffs contend that both the August 8 and the August 28 proxy statements were misleading. They also contend that the net result of the sale by Nimmo and the subsequent merger was Nimmo's receipt of an unjustified premium for his control of Great States and the minority shareholder's receipt of grossly devalued stock of State Security in return for their stock in Great States.

[19]So long as the meeting was held on or after August 28, 1968, State Security would vote Nimmo's stock, pursuant to the proxy agreement included in Paragraph 20 of the May 10, 1968, agreement.

[20]This involves the same "curiosity" as that involved in his signature on the agreement. These acts by Mr. Reid were ratified on behalf of Great States by the newly-elected board on September 30, 1968.

III. ISSUES PRESENTED.

There are a number of complex issues involved in the foregoing statement of facts. However, despite the numerous allegations tossed around by the plaintiffs, defendants are essentially correct in narrowing their focus to the issues involving the propriety of the service obtained in this case. This issue is particularly relevant to Nimmo and his company since they have been called before this Court under the long-arm provisions of the national securities acts.

As the Court's order of June 20, 1972, indicates, the question whether the "V.I.P." contracts are "securities" is appropriately addressed on more evidence than is normally available upon motions to quash. Since the merits of the issue are so intertwined with the jurisdictional issues, summary judgment is a more appropriate vehicle for resolution of the question. If, for example, it is found that the "V.I.P." contract is not a security, then, insofar as that issue is concerned, Nimmo's and his company's motion to quash are due to be granted, while State Security's motion to dismiss for failure to state a claim would also be due to be granted.

This memorandum, however, addresses the further issue — not raised in the June 20, 1972, order, but briefed by the parties — of the alleged fraud in regard to the 1968 sale of Nimmo's stock to State Security. The latter issue must be reached if the Court is to explore all jurisdictional bases at this time.

With the foregoing in mind, this memorandum considers the following issues:

(1) Does this Court have jurisdiction over Nimmo under the 1933 or 1934 Acts?

(a) On its face, is the "V.I.P." contract a "security" under either Act?

(b) If not, did the manner of sale of these contracts transform them into securities?

(2) Are there any other jurisdictional bases upon which this Court may hold Nimmo accountable with regard to these contracts?

(3) Has a cause of action been stated as to the 1968 merger of Great States into State Security?

(4) Is jurisdiction over Nimmo and his company proper as to the counts involving the 1968 merger?

(a) Was either defendant a "controlling" person of the entities perpetrating the alleged frauds?

(b) May the defendants be held under a conspiracy theory?

IV. CONCLUSIONS.

It is concluded herein that the "V.I.P." contracts are insurance contracts, exempt from the 1933 and 1934 Acts. It is further concluded that plaintiffs have stated a cause of action against all defendants as to the 1968 merger, so that the Court has personal jurisdiction over all defendants.

V. DISCUSSION.

As stated above, the plaintiffs contend that the "V.I.P." contract is a security under the 1933 and 1934 Acts, while defendants say it is merely a contract of insurance.

If plaintiffs are correct, then this Court has jurisdiction — both personal and subject matter — over the defendants under the jurisdictional provisions of the 1933 and 1934 Acts. Section 22 (a) of the 1933 Act, 15 U.S.C. § 77v (a) (1970), provides:

> **The district courts of the United States . . . shall have jurisdiction . . . of all . . . actions at law brought to enforce any liability or duty created by this [act]. Any such suit or action may be brought in the district where the offer or sale took place, if the defendant par-**

> ticipated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.

Section 27 of the 1934 Act, 15 U.S.C. § 78aa (1970), provides:

> The district courts of the United States . . . shall have exclusive jurisdiction . . . of all . . . actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. . . . Any [such] action . . . may be brought in [the district wherein any act or transaction constituting the violation occurred] or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.

Since liabilities and duties under both acts hinge upon the presence of a "security," it is clear that if the "V.I.P." contracts are not securities, then this Court does not have subject-matter jurisdiction over this suit under the above provisions. Moreover, service of process upon defendants Nimmo and his company would not be proper under the provisions.

Section 3 (a) of the 1933 Act, 15 U.S.C. § 77c (a), makes certain exemptions:

> Except as hereinafter expressly provided, the provisions of this subchapter shall not apply to any of the following classes of *securities*:
>
> * * *
>
> (8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia [.] [emphasis supplied]

There is no similar exemption from the 1934 Act; moreover, sections 12 (2) and 17 (c) of the 1933 Act, 15 U.S.C. §§ 77l (2), 77q (c) (1970), expressly provide that the exemptions of section 3 do not apply to the anti-fraud provisions of the 1933 Act.

Seizing upon these features of the two acts, plaintiffs contend that the 1934 Act, especially Section 10 (b) thereof, 15 U.S.C. § 78j (b) (1970), and the anti-fraud provisions of the 1933 Act apply to insurance contracts. They argue that Section 3, because of its reference to "the following classes of securities," treats insurance contracts as securities. It follows, therefore, that the above anti-fraud provisions and the 1934 Act apply to insurance contracts because they are "securities."

The plaintiff's argument is persuasive if only the language of the two acts is considered. However, Professor Loss provides the following explanation of the § 3 (a) (8) exemption:

> Section 3 (a) (8) of the Securities Act exempts "any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia."
>
> This is a perfect example of how it sometimes does not pay to be too cautious. Without this exemption, and without any specific reference to insurance policies in the definition of "security," and at a time when *Paul v. Virginia* [8 Wall. 168 (U.S. 1869)] was still the law of the land, it is hardly conceivable that Congress would have subjected insurance policies to federal control *sub silentio*, even control which was merely of the disclosure variety. As it is, § 3 (a) (8) seems on its face to create a negative implication that insurance policies *are* securities, which may be exempt from

> the registration requirements but are subject to the antifraud provisions. Nevertheless, the Commission has taken the position that insurance or endowment policies or annuity contracts issued by regularly constituted insurance companies were not intended to be securities, and that in effect § 3 (a) (8) is supererogation. This undoubtedly carries out the legislative intention; for the House report states that the purpose of the exemption "makes clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the act." 1 Loss, *Securities Regulation* 497 (2d ed. 1961) (footnotes omitted).

Professor Loss's analysis has been cited with approval by the Supreme Court in *Tcherepnin v. Knight*, 389 U.S. 332, 342 n. 30 (1967). The Court stated, moreover:

> Congress specifically stated that "insurance policies are not to be regarded as securities subject to the provisions of the act," and the exemption from registration for insurance policies was clearly supererogation. *Id.* [citations omitted].[21]

Since the definition of "security" found in section 3 (a) (10) of the 1934 Act, 15 U.S.C. § 78c (a) (10), is virtually identical to that in section 2 (1) of the 1933 Act, 15 U.S.C. § 77 (b) (1), it seems reasonable that Congress intended to exclude insurance contracts from the 1934 Act as we have seen it did with regard to the 1933 Act.[22] Therefore, the

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[21]*See also S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 98 (1959) (Harlan, J., dissenting).

Plaintiffs argue that *S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969), supports their contention. That case, however, held that the federal securities acts applied to relationships between an insurance company and its stockholders, while saying nothing about whether insurance policies are "securities."

[22]Plaintiffs also argue that the § 3 (a) (8) exemption be construed narrowly to apply only to "pure 'risk' insurance contracts." This argument falls before the same legislative intent rehearsed above.

issue is whether the "V.I.P." contract is an insurance policy or some breed of security.

"Insurance" is a mercurial term, describing a myriad of contractual relationships and constantly expanding as new risks are created by the activities, and the changing perceptions of value attendant thereto, of men. Any attempt to define the term strictly is certain to fail. Insurance often entails an investment feature as well as an assumption of risk feature; when the assumptive feature becomes secondary to the investment feature, the insurance assumes more and more the attributes of a security. As Professor Loss has indicated:

> In the last analysis, there is no escaping the fact that there is a continuous spectrum from a one-year term life insurance policy, which is pure insurance, through the various forms of straight life and endowment policies, to the annuities, both fixed and (in varying degrees) variable, to mutual fund shares and ultimately common stock, which represent pure investment. 4 Loss, *Securities Regulation* 2534 (1969 Supp. to 2d ed.).

The Supreme Court has twice attempted to provide points for drawing the line between insurance contracts, which are exempt from the federal securities acts, and securities, which are not, in *S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) ["VALIC"] and *S.E.C. v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) ["UBLIC"].

In *VALIC*, the Court considered whether variable annuity contracts, issued by insurance companies regulated by the insurance commissioners of a number of states (including Alabama), were exempt from the disclosure provisions of the 1933 Act, 15 U.S.C. § 77a, and from compliance with the Investment Company Act of 1940, 15 U.S.C. § 80a. The contracts in question included certain conven-

tional insurance features: declining term insurance for the first five years of pay-in, disability waiver of premium, and, most significantly, the assumption by the company of the entire risk of longevity.[23] These provisions, however, were deemed incidental to the primary form of the investment, which called for participation by the insured on a per-unit basis, in the entire portfolio of the company. The company's obligation, then, was always stated in terms of the present condition of its investment portfolio, not in terms of dollars.

Finding no guarantee of fixed income, the Court concluded that "the variable annuity places all the investment risks on the annuitant, none on the company." *Id.*, at 71. Concurring for himself and Justice Stewart, Justice Brennan provided a more detailed analysis of the risks assumed by the company during the pay-in period of the policy:

> The contract uses insurance terminology throughout and many of the common features of life insurance and annuity policies are operative in regard to it at this "pay-in" stage. There are "incontestability" and "suicide" clauses (which mainly relate to the term insurance); a "grace period" allowed for the payment of premiums; a provision for "policy loans" (the drawing down of accumulated units in cash, subject to replacement later to the extent that repayment of the amount of money received will then permit, the transaction bearing a resemblance to the liquidation by a common stock investor of his holdings in anticipation of a "bear market"); and provision for a "cash value" (that is,

[23]This means that, upon reaching the maturity date, the insured's interest in the general fund would be evaluated in terms of the amount paid in by the insured, as a function of a standard annuity table. This figure is then used to determine the number of "annuity units" to be paid the insured. Although the actual amount paid the insured would fluctuate every month with the value of the fund, he would receive the value of his annuity units every month, regardless of how long he lived. Thus, if the company had a "poor" longevity experience, compared to the actuarial predictions, it stood to lose substantially.

> for the cashing in of the accumulated units, subject to a surrender charge in the early years). And very certainly the commitment of the company eventually to disburse the accumulated values on a life annuity basis once the pay-in period is over is present throughout this period. But what the investor is participating in during this period, despite its acknowledged "insurance" features, is something quite similar to a conventional open-end management investment company, under a periodic investment plan. The investor's cash (less a charge analogous to a loading charge, which is, at least in the early years, very high, but which it should be said, has to cover annuity premium taxes and some quite conventional mortality risks) goes to buy "units" in a portfolio managed by the persons in control of the corporation. His "units" fluctuate with the income and capital gain and loss experience of the management of the portfolio. He may cash them in, wholly or partially. The amount of his equity is subjected to a charge, on asset value, of 1.8% per annum. Except for the temporary term insurance and the waiver of premium coverage, the entire nature of the company's obligation to its investor during this period is not in dollars (though of course it will be converted into them, just as a commodity transaction can be), but solely in terms of the value of its portfolio. 359 U.S. at 84-5.

It may be seen then, that the insureds in *VALIC* were buying into a fund, with the prospect of reaping the benefits of profitable management of the fund. There was simply no fixed dollar risk on the insurer nor any basis for a concommitant expectation by the insured. Under these conditions, the Court held that the investment contracts were not exempt from either the 1933 Act or the Investment Company Act of 1940.

Eight years later, the Court addressed the question once again in *UBLIC*, with Justice Harlan, a dissenter in *VALIC*, writing for a unanimous Court. In *UBLIC*, an

established, old-line insurance company offered an investment contract with bifurcated interests. The plan, called a "Flexible Fund," provided, during the pay-in period, for the insured's *pro rata* participation in a general investment fund. At the same time, he was guaranteed a minimum dollar amount, called the net premium guarantee. At maturity, the insured could elect various conventional annuity plans, none of which were dependent upon the value of the pooled funds of all insureds, as was the case in *VALIC*. Addressing only the first half of this scheme, the Court determined that the guaranteed dollar value associated with the pay-in period was "substantially less than that guaranteed by the same premiums in a conventional deferred annuity plan," 387 U.S. at 208. Thus, although there was some slight shifting of risk from insured to insurer, the basic framework of the pay-in period rested upon the same kind of investment fund which the Court had faced in *VALIC*. The Court thus held that the pay-in portion of the "Flexible Fund" contracts were not exempt insurance contracts and were therefore subject to the disclosure provisions of the 1933 Act.

The insurance contract at issue in the present case does not promise its holders that the amount of insurance they are purchasing is contingent upon how well a general fund is invested. Instead, the insureds are promised a fixed amount of insurance each year, and fixed options at the end of 10 years and 25 years. The insurance promised is not set at the illusory levels held to be tantamount to no insurance in *UBLIC*.

Plaintiffs also attack the following participating provision of the contracts:

> The proportion of divisible surplus accruing upon this policy shall be ascertained annually by the company.

> Beginning at the end of the second policy year, and on each anniversary thereafter, such surplus as shall have been apportioned by the company to this policy shall be available under any of the following options, upon written request by the person having control of this policy: (1) applied toward payment of renewal premiums; or (2) applied to purchase participating paid-up additional insurance payable under the same terms and conditions as this policy; or (3) left with the company to accumulate at interest at a rate of not less than 2½% per annum compounded annually; or (4) paid in cash. Outstanding dividend accumulations may be withdrawn in cash or shall be payable at the maturity of this policy to the person or persons entitled to its proceeds. If no option is selected, such divisible surplus will be paid in cash.

This provision is unlike the fund created in *UBLIC*, which, as has been noted, created insurance as a non-guaranteed portion of an investment fund. In the Great States contract, on the other hand, the participating feature is in addition to a *bona fide* insurance scheme and may be viewed as a reduction of premium. *VALIC*, 359 U.S. at 90 (Brennan, J., concurring).

Similar participating features are common in the insurance industry, 43 Am. Jur. 2d, *Insurance* § 120, pp. 177-8 (1969); 44 C.J.S., *Insurance* § 103, pp. 639-41 (1945); 1 Appleman, *Insurance Law and Practice* § 9 (Rev. ed. 1965), and they reflect the investment experience of the company, mortality savings, and savings in administrative costs. In the Great States policy, the participating feature is denominated as a "dividend," not as a "security" or as an ascertainable share of an investment fund. This feature, then, is not separable from the indisputably insurance aspects of the contract, and it is not a "security." Thus, it does not remove the "V.I.P." contract from the insurance

exemptions of the 1933 and 1934 Acts.[24] *Cf. Olpin v. Ideal National Ins. Co.*, 419 F.2d 1250 (10th Cir. 1969).

Plaintiffs argue that the coupons attached to the "V.I.P." policy are additional evidence that the policy is a "security" and not an insurance contract. This contention is unpersuasive.

The coupons provide:

> Subject to the provisions of [this] policy . . . and upon the payment of 2nd annual premium in full and not otherwise, Great States Life Insurance Company will pay to the order of the insured under said policy [a stated sum] or upon written request of the insured within thirty-one days after said date will apply said sum to the purchase of a paid-up life addition of [a stated sum].

The sum to be paid to the insured under the sample policy ($249.30) remains the same every year, while the amount of additional insurance which may be purchased declines by $30.00 each year. Various inducements are offered to the insured to refrain from cashing in his coupons, and each of them is plainly stated in the initial page of the contract. Such coupon policies are not widely used, but they are a standard form of insurance. 1 Appleman, *supra,* § 10. In effect the coupons are a guaranteed dividend, or rebate of premium. They are not premised upon a share in an investment pool and in no way represent a "security."

Their presence on an insurance policy, of course, may lend themselves to abuse, since the coupons might be compared to those on a bond, for example. The Insurance

[24]This conclusion is reinforced by Judge McFadden's similar conclusion in *Hilgeman v. National Insurance Co. of America,* 1970 CCH Fed. Sec. L.Rep. ¶ 92,647 (N.D. Ala., April 22, 1970), *rev'd* 444 F.2d 446 (5th Cir. 1971). However, because of the confusing aspects and the ambiguous language of the Fifth Circuit in that case, no reliance is explicitly placed upon it.

Commissioner of Alabama apparently objected to the policies on this basis, as have other state commissioners. 1 Appleman, *id.* However, this fact does not change the exempt status of these insurance policies; rather it confirms the Congressional choice, embodied in the insurance exemption, to leave the regulation of insurance and its sale to the states. *Cf. VALIC*, 359 U.S. at 75 (Brennan, J., concurring).

The plaintiffs argue furthermore that these policies are transformed into "securities" because of the inclusion in each policy of a statutory provision drawn from Illinois law. The provision, as it appeared in the policy, is included in the statement of facts of this memorandum. While it is certain that this provision, like the coupons, may lend itself to abuse in the hands of unscrupulous salesmen, it does not change the character of the contract from one of insurance to an investment contract which is not exempt from the 1933 and 1934 Acts. The excerpt provides that at least 90 percent of the profits derived from participating policies shall inure to the benefit of the participants. To facilitate enforcement of this provision, a company issuing both participating and non-participating policies is enjoined to keep a separate accounting of the profits derived from the different types of policies. It is undisputed that Great States (and State Security) failed to keep this separate accounting. It is further undisputed that Great States lowered its dividends to its participating policy-holders in 1967. None of these facts changes the character of the risk assumed by the insurance company nor the kind of contract which the insured bought. The "V.I.P." contract is still insurance.

Plaintiffs also present a welter of information regarding the sales pitch given each plaintiff regarding the "V.I.P." contracts. The plaintiffs argue that these facts should be considered in determining whether the "V.I.P." contracts

were securities. They rely upon the Supreme Court's language in its seminal decision of *S.E.C. v. Joiner Corp.*, 320 U.S. 344, 351 (1943):

> In the Securities Act the term "security" was defined to include by name or description many documents in which there is common trading or speculation or investment. Some, such as notes, bonds, and stocks, are pretty much standardized and the name alone carries well-settled meaning. Others are of more variable character and were necessarily designated by more descriptive terms, such as "transferable share," "investment contract," and "in general any interest or instrument commonly known as a security." We cannot read out of the statute these general descriptive designations merely because more specific ones have been used to reach some kinds of documents. Instruments may be included within any of these definitions, as a matter of law, if on their face they answer to the name or description. However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as "investment contracts," or as "any interest or instrument commonly known as a 'security.'" The proof here seems clear that these defendants' offers brought their instruments within these terms.

The Court concluded its opinion by noting that in order to prove a document a "security," it might be necessary, as was done in *Joiner* to "go outside the instrument itself. . . ." *Id.*, at 355.

Joiner, however, involved the sale by defendant of leaseholds in small parcels of land in Texas to purchasers scattered around the nation. The evidence aside from the leases themselves indicated that woven into the sale of the leasehold was an assurance that the seller would under-

take to drill a well which might enhance the value of all the nearby leaseholds. Thus, the additional evidence there indicated that the buyers were purchasing not a leasehold but an agreement to drill a well. The proof showed that the buyers were investing in the efforts of another with an expectation of profit from the other's efforts.

On the other hand, none of the evidence brought forth by plaintiffs here remotely suggests such a relationship. At most, plaintiffs indicate that the salesmen treated the "V.I.P." insurance contract as if it were a "security."[25] These facts would tend to show common law fraud in the sale of the insurance contract, but they would not transform the nature of the contract itself. The insurance nature of this contract is plain and substantial on the face of the document, and the plaintiff has failed to show how the evidence outside the document would change its essential nature. *See Chapman v. Rudd Paint & Varnish Co.*, 409 F.2d 635, 640-1 and n. 5 (9th Cir. 1969); *cf. S.E.C. v. W. J. Howey Co.*, 328 U.S. 293 (1946).[26]

At this point, it is clear that there is no personal jurisdiction over Nimmo or his company on this claim under the securities act long-arm statutes. Service as to them should therefore be quashed as to all counts relying upon the "V.I.P." contracts. The Court should, in light of the second part of this memorandum, also dismiss as to this count for failure to state a cause of action against these two defendants.

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[25]Plaintiffs underscore the use of the word "investment" in the contract and in the sales pitch. Although this term is subject to much abuse, it seems indisputable that insurance is usually a form of "investment." *See VALIC, supra,* 359 U.S. at 75 (Brennan, J., concurring). Use of this term hardly warrants a finding that the contract here in issue was a "security."

[26]The same conclusion must be reached as to a cause of action under the Alabama Securities Act, Tit. 53 §§ 28, 45, *Code of Alabama 1940* (Recomp. 1958) (1973 Cum. Supp.), since that act likewise does not encompass causes of action based upon *bona fide* insurance contracts.

The situation is different as to State Security. It was served through the Superintendent of Insurance of Alabama. Personal jurisdiction is therefore established. Subject matter jurisdiction is predicated not only upon the Securities Acts, but also upon diversity of citizenship. Therefore, the quashing of service as to the Nimmo group does not require similar treatment of State Security, assuming there are causes of action alleged aside from those dealing with breaches of the securities acts.

Plaintiffs have alleged causes of action sounding in common law fraud and breach of contract. As to the former, the affidavits filed by the plaintiffs indicate that there are material and substantial factual contentions upon which a cause of action in fraud may be grounded. The admission of all defendants that the profits from the participating policies were never kept separate indicates a substantial breach of contract claim and may entitle plaintiffs to an accounting from State Security.[27]

Note, however, that neither Nimmo nor Nimmo Inc., as officers or shareholders of Great States, are personally liable for the fraud or breach of contract claims. Neither is alleged to have participated in the sales pitches given to the individual plaintiff-buyers. And the corporate structure shields them from the alleged breach of contract. Therefore, these claims, likewise, must be dismissed as to them for failure to state a cause of action.

This disposition, however, likewise precludes a class action as to either of these claims. The fraud claims each depend upon the particularized representations made to each plaintiff. The contract claim depends upon whether the

[27]This is a conclusion only as to whether a cause of action has been stated. It is not intended to preclude the defendant's raising defenses, such as statute of limitations, by way of answer or motion for summary judgment. Nor is this intended to establish that State Security must answer for torts allegedly committed by Great States or its agents.

excerpt from Illinois law was included in each plaintiff's insurance contract; since there is evidence in Mr. Nimmo's deposition that it was not the company's practice to include the excerpt in the policies, it would be inappropriate to assume that every class member received it as a part of his contract.

Under these circumstances, a class action may not be maintained as to the two claims on the "V.I.P." contract. F.R.Civ.P. 23 (b) (1) (A) is not satisfied because, as to the two remaining claims, there are no "standards of conduct" sought to be imposed upon the defendant. R. 23 (b) (1) (B) is likewise unsatisfied because adjudications of the individual claims will not be dispositive of the interests of other members not parties to this suit, since the individual claims each depend upon facts peculiar to that individual. For the same reason, R. 23 (b) (3) is not satisfied since the questions of fact peculiar to each plaintiff outweigh any common questions involved.

It likewise is inappropriate to grant plaintiffs' motion for summary judgment as to Counts One through Six, filed September 23, 1974, even as to breach of the provision regarding the separate accounts. While plaintiffs have presented strong evidence as to this breach, defendant State Security has not been heard from on this issue as of this time.

B. Remaining for resolution are the issues surrounding the merger of Great States into State Security in 1968. For the purposes of this memorandum, the issues treated will be those necessary to dispose of Nimmo's and his company's motions to quash or dismiss. These matters are not treated as motions for summary judgment on the merits. Consideration of affidavits and other evidence upon motions to quash does not thereby transform the motions into sum-

mary judgment adjudications. *See* 5 Wright and Miller, *Federal Practice and Procedure* § 1351, at 565 (1969).

Naturally, we look first to determine whether a cause of action has been stated as to any defendant. In assessing this issue, the complaint is weighed heavily in plaintiffs' favor. *Conley v. Gibson*, 355 U.S. 41 (1957). Moreover, to accomplish the broad anti-fraud objectives of the securities acts, the statutes upon which plaintiffs rest their case must be construed "flexibly, not technically and restrictively." *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *see Herpich v. Wallace*, 430 F.2d 792, 802 (5th Cir. 1970).

Under these principles, whether plaintiffs have stated a cause of action is nevertheless problematical. In essence, it is alleged that Nimmo and his company contrived to sell their stock in Great States to State Security at a premium, with a resultant dilution of the value of Great States' stock in the hands of minority shareholders, including plaintiff Grainger. This was accomplished, as seen in the statement of facts, through the sale of stock to State Security and the subsequent merger of Great States into State Security. Under the wide umbrella of this transaction, plaintiffs also charge violations of the proxy rules.

Plaintiffs sue on their own behalf and on behalf of Great States. Therefore, they have two analytical bases upon which to premise compliance with the doctrine of *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952), to the effect that standing to seek redress for violations of Rule 10b-5 requires a "purchase" or a "sale."

In their latest brief, plaintiffs assert that the facts alleged show that Great States' assets were used to purchase Great States' stock. This telescopes the allegations, for the actual facts show that Nimmo sold to State Security. State Security

borrowed funds from a third party to make the purchase. Then Great States was merged into State Security. The only sense in which Great States purchased its securities from Nimmo is that, subsequent to the merger, Great States' assets were subject to the loan obtained to buy Nimmo's stock. However, there is no allegation that the loan was obtained on the strength of the proposed merger, nor is there an allegation that the Great States' assets were subjected to the terms of the loan. Nevertheless, the facts alleged are sufficient to establish a kind of "purchase" by Great States sufficient to warrant a derivative action on its behalf. *Herpich v. Wallace*, 430 F.2d 792, 807-10 (5th Cir. 1970); *cf. Dasho v. Susquehanna Corp.*, 380 F.2d 262, 267 (7th Cir. 1967), *cert. denied sub non, Bard v. Dasho*, 389 U.S. 977 (1967) ["Dasho I"]. The proof as to the cause of action must be directed to whether the scheme complained of was carried on to defraud Great States and whether Great States has been proximately injured thereby. *Herpich, supra*, at 810.

As to the individual plaintiffs, the Graingers, their standing must rest upon their exchange of Great States' stock for State Security's stock. In *S.E.C. v. National Securities, Inc.*, 393 U.S. 453, 467 (1969), the Supreme Court held that an exchange of stock in a merger context was a "purchase." The Court made it clear, however, that its holding was determinative only as to a suit by the S.E.C., and it explicitly declined to address the question for purposes of a private action like the present one. Nevertheless, the extension is a natural one, for by exchanging their shares in Great States for shares in State Security, the plaintiffs have converted their investment from one company to another, precisely the type of situation sought to be covered by the 1934 Act. Moreover, the exchange was the final step in the alleged fraud. Thus, it seems clear that plaintiffs are "purchasers"

within the meaning of the 1934 Act. 15 U.S.C. § 78c (13); *see* Whitaker, *The Birnbaum Doctrine: An Assessment*, 23 Ala. L. Rev. 543, 555 n. 57 (1971).

Once the "purchase" requirement is met, the facts state a cause of action for violation of Rule 10b-5. *Herpich v. Wallace, supra; Dasho I, supra.*[28] It is well to point out that plaintiffs' allegations of fraud in the overall transaction merit full development upon motions for summary judgment. *Herpich* and *Dasho I* are both distinguishable. Both cases involved a similar scheme, but in both the defrauded corporation was the final purchaser of its own over-valued stock; the merger brought into the complaining corporation both the loan *and* the stock. In this case the merger brought in nothing but assets which might be charged with the loan which was already held by the surviving corporation. However, this distinction does not vitiate the plaintiffs' claim since they assert that the net effect was to pay Nimmo and his company a premium,[29] at the expense of his fellow Great States shareholders. This allegation raises fraud regardless of how the sale and merger were structured, so long as material facts were withheld from the plaintiffs. While there may be no fiduciary duty on the part of a majority stockholder to report every offer he gets to his fellow shareholders, there is a duty of disclosure where those shareholders may be charged with the burden of the premium price paid. *Dasho v. Susquehanna Corp.*, 461 F.2d 11, 26 (7th Cir.), *cert. denied*, 408 U.S. 925 (1972) ("Dasho II"). The failure to make such a report may constitute a portion of a larger scheme to defraud the shareholders, regardless

[28]It needs emphasis that this memorandum addresses only the allegations and whether they state a cause of action. No attempt has been made to deal with the statute of limitations or any other issues.

[29]Whether a premium was in fact paid is unclear from the evidence now before the Court, especially in light of Nimmo's assertion that the assets he was required to buy from Great States, in order to consummate the sale, were over-valued in the contract of sale. *See* fn 18, *supra*.

of the right of a majority shareholder to receive a premium for his shares. *Cf. Dasho II, supra,* at 33.

This disposition requires the Court to reach Nimmo's motion to quash.[30] He is correct in arguing that his sale of the Great States stock precludes this Court's assertion of personal jurisdiction over him solely on the basis of the August 28, 1968, proxy statement. *Gould v. Tricon,* 272 F. Supp. 385 (S.D. N.Y. 1967). That he was still technically a member of the board of Great States on August 28, 1968 (since his replacement was not formally chosen until August 30, 1968), does not change the result, since his prior sale of his stock precluded his having any direct hand in the preparation of that proxy statement. Thus, the allegedly false and misleading statements made therein — on which plaintiffs rely heavily — will not support personal jurisdiction over Nimmo.

Nor may this Court hold Nimmo as a "controlling person" under 15 U.S.C. § 77o. Plaintiffs argue strenuously that his receipt of $30,000.00 from State Security as a consultant in the year following the merger and his retention of the power to approve every check issued by Great States in excess of $1,000.00 make him liable for the fraudulent acts of State Security following the sale. To find control, the securities laws require:

> . . . [t]he possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. Rule 405, 1933 Act; Rule 12b-2, 1934 Act.

Neither of the above contractual terms gave Nimmo control over Great States for purposes of the August 28, 1968, proxy statement, particularly in light of the undisputed evidence

[30]For the desirability of the Court's treating documents outside the pleadings, see text at pp. 26-7, *supra.*

that he asked, but was never allowed, to exercise his check approval authority. *See Ayers v. Wilfinbarger*, 491 F.2d 8 (5th Cir. 1974) ; *United States v. Sherwood*, 175 F. Supp. 480-3 (S.D. N.Y. 1959) .

However, Nimmo and his corporation may be required to answer to this Court under plaintiffs' conspiracy count. As it is now before this Court,[31] plaintiffs argue that the August 8, 1968, proxy statement was misleading in that it did not adequately disclose the premium which Nimmo and his company received for sale of control, and that it did not adequately disclose the fact that the ensuing merger would have the effect of charging the Great States minority shareholders with the premium price. While the August 8, 1968, statement does disclose, at page 3, the basic facts from which the above conclusions could be drawn, a question for further development is presented as to whether this disclosure was adequate.

Given this substantial link between the May 10 sales agreement and the September 20 merger, it cannot be said that there is no evidence of a conspiracy here, by which Nimmo agreed to sell his stock in Great States to State Security, with a subsequent merger so that the majority shareholders of Great States would be charged, at least in part, with the burden of paying for the control premium. That Nimmo and his company may have been a part of this conspiracy is sufficiently raised by plaintiffs' documentary evidence regarding the aborted sale and the subsequent lawsuit. Certainly the two defendants may be charged with knowledge of the scheme even if they did not originate it,

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[31]Plaintiffs' complaint makes no mention of the August 8, 1968, proxy statement in its substantive allegations; there is a veiled reference to it in the "venue" portion of the complaint. Beginning with their brief of December 30, 1969, however, this proxy statement has assumed added importance until, in their latest brief, plaintiffs aver that the August 8, 1968, proxy statement is materially misleading and in furtherance of the conspiracy. The conspiracy itself is clearly alleged in the complaint.

especially in light of the benefits they derived from it. *Herpich v. Wallace*, 430 F.2d 818, 819 (5th Cir. 1970).[32]

Jurisdiction over Nimmo then may be had under the conspiracy count. *Wyndham Assoc. v. Bintliff*, 398 F.2d 614, 620 (2d Cir. 1968). Commission of any act in furtherance of the conspiracy here likewise makes venue appropriate in the Northern District of Alabama. *Int'l Controls Corp. v. Vesco*, 490 F.2d 1334, 1347 (2d Cir. 1974).

This conclusion makes it unnecessary to reach other contentions raised by the parties.

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[32]Defendants stress the dismissal of the suits against three defendants, situated similarly to Nimmo, in *Dasho II, supra*, at 33. This dismissal must be viewed in light of the plaintiffs' abandonment there of their conspiracy counts. *Id.*, at 16.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1253

LESLIE W. NIMMO, et al.,
Petitioners,
(Defendants Below),

v.

CHARLES S. GRAINGER, et al.,
Respondents
(Plaintiffs Below).

BRIEF IN OPPOSITION TO CERTIORARI

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BRIEF IN OPPOSITION TO CERTIORARI

Respondents Charles W. Grainger, et al., (herein "plaintiffs") respectfully file this brief in opposition to the writ of certiorari requested by the petition for certiorari (herein "petition") filed on behalf of Leslie W. Nimmo, et al., (herein "defendants").

We shall attempt in this brief to demonstrate that the defendants have misstated the facts, the questions presented for review by this Court, and the nature of the rulings below.

We shall also attempt to demonstrate that the decision below (which remanded this action for reconsideration by

the district court) is not ripe for review by this Court; that the decision below is not (as defendants claim) in conflict with a decision of another court of appeals; and that the court of appeals has not (as defendants claim) "so far departed from the accepted and usual course of judicial proceedings . . . as to call for the exercise of this Court's power of supervision."

QUESTIONS PRESENTED FOR REVIEW BY THIS COURT

The defendants' petition erroneously describes the Great States "Variable Investment Plan" contract sold to each plaintiff as "*a life insurance policy* with a *standard* participating provision," and (at p. 3) suggests that the first question presented for review by this Court is whether such a contract can ever "become" a "security" under the Federal Securities Laws. So framed, the question posed by defendants assumes that a number of disputed and as yet undecided factual and legal issues will be determined in defendants' favor. The district court and the court of appeals have *not* held that Great States "Variable Investment Plan" contract is a "security." Instead, the court of appeals has held (1) that the district court erred in dismissing Counts 1, 2 and 3 of the complaint for failure to state a claim under the Securities Act of 1933 and the Securities Exchange Act of 1934; and (2) that the district court, in ruling on any motion for summary judgment, should not limit its consideration to the face of the instrument sold, but may also properly consider all the facts and circumstances of the offering, including written and oral sales presentations, and in addition may properly consider expert actuarial testimony with respect to the relationship between the size of the death benefits and the size of the "premiums" charged for the "Variable Investment Plan" contracts.

Defendants' petition erroneously characterizes Great States "Variable Investment Plan" contract as a "standard" insurance

contract. It is not. Notwithstanding defendant Nimmo's testimony to the contrary (App. 56), there is testimony by the Alabama sales manager for Great States to the effect that Great States attached to each "VIP" contract a mimeographed copy of an Illinois statute which stated that any company selling participating policies must keep a separate accounting and pay out 90% of its profits on such contracts. (App. 114-116, 69, 166-167). In addition, attached to each contract were "coupons" which resembled bond coupons. (App. 168).

Far from being "standard" insurance contracts, the "VIP" contracts sold to plaintiffs by Great States were "specialty" contracts, with attachments and features which have been expressly prohibited in Alabama and most other States on the ground that they tend to mislead the purchaser into thinking that he is buying an "investment." (App. 127, 64). See Departmental Regulation No. 17, Regulations of Alabama Department Insurance (April 20, 1967, effective June 1, 1967); Kimball and Hanson, "The Regulation of Specialty Policies in Life Insurance," 62 Mich. L. Rev. 167, 204 (1963).

The second question for review by this Court, according to p. 3 of defendants' petition, is whether the court of appeals below erred in treating the district court's ruling as a ruling on motion to dismiss, and instead should have treated the district court's ruling as a grant of summary judgment. The record demonstrates, however, that the district court's June 5, 1975 order dismissed Counts, 1, 2 and 3 of the complaint "for failure to state a claim." (App. 160) Thus, the district court's order of June 5, 1975 appears to have been entered pursuant to Rule 12(b), rather than Rule 56, as defendant's claim.

STATUTES INVOLVED

Defendants' petition fails to call to this Court's attention the provisions of §§ 12(2) and 17(c) of the 1933 Act. Those sections of the 1933 Act make it clear that "exempt securities" (such as U. S. bonds, municipal bonds, and any "insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner," etc.) are exempt from registration with the SEC but are *not* exempt from the *antifraud* prohibitions provided by §§ 12(2) and 17(a).

Section 17(c), 15 U.S.C. § 77q(c) states:

> "Sec. 17. (c) The exemptions provided in section 3 shall not apply to the provisions of this section."

Similarly, Section 12 of the 1933 Act, 15 U.S.C. § 77l states:

> "Sec. 12. Any person who—
>
> "(1) offers or sells a security in violation of section 5, or
>
> "(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity

in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

STATEMENT OF THE CASE

A. The Facts.

Commencing in or around 1962, the individual plaintiffs were approached by various salesmen employed by the Great States Life Insurance Company ("Great States"), an Illinois insurance company controlled by two of the defendants (L. W. Nimmo and Nimmo & Associates, Inc.), and the predecessor in interest to the defendant State Security Life Insurance Company (App. 10-11). These salesmen urged the various individual plaintiffs (and the members of the class they seek to represent) to purchase investments known as Variable Investment Plan ("VIP") contracts (App. 11). Although these VIP contracts had certain common insurance attributes, such as a guaranteed death benefit, in order to sell these contracts the plaintiffs were told by the defendants' salesmen that these VIP contracts "were * * * an investment, not insurance" (App. 166; *see also,* App. 114, 117). Indeed, the district court has found that "the salesmen treated the 'V.I.P.' * * * contract as if it were a 'security' " (App. 192). The emphasis in every sales effort was the opportunity to realize profits from the managerial efforts of the defendants. Focusing upon the non-insurance aspects of these VIP contracts, the defendants' contracts, as explained by the defendants' salesmen, were purveyed as offering the plaintiffs "as much as 40 per cent interest" on their periodic investments (App. 166).

In this regard, the profit potential of these VIP contracts takes on added significance. The actual contracts, as well as the written sales materials used to sell them, called attention to the fact that the defendants would establish a separate accounting for the benefit of all VIP contract holders (App. 115, 167). These funds were to be managed by the defendants, and at least 90 percent of the "profits" derived from the defendants' managerial efforts with these funds were to be returned to investors, in the form of periodic "dividends" (App. 69, 114, 115, 166, 167). This promise—of the establishment of a separate accounting and the payment of 90 percent of the profits to be derived from the defendants' management of VIP contract investments —was not, however, wholly gratuitous. Illinois law apparently required this promise, at least as to sales in that state. The defendants, in any event, purported to act in accordance with that statutory obligation, although their attention to statutory requirements proved to be short-lived. Soon after the sales of VIP contracts to the plaintiffs commenced, the defendants were "instructed * * * to cease selling * * * VIP [contracts] in * * *" Alabama, since these VIP contracts were of " 'a profit-sharing or investment nature' [and] had not been approved for sale in Alabama" (App. 169). Nonetheless, the defendants continued to sell these VIP contracts to the plaintiffs and others situated in Alabama and elsewhere (App. 111, 169).[1]

In July, 1966, a new dividend scale was unilaterally adopted by Great States. Under this new scale, instead of distributing 90 percent of the profits derived from its separate VIP accounts to

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[1] Additional investment incentives were also offered—in the form of twenty-four special coupons attached to each contract. Denominated as "Guaranteed Premium Reduction Coupons," "[t]hese coupons guaranteed payments of stated amounts of cash by Great States * * * upon surrender of the coupon" (App. 168). In addition, "[p]rovisions were also made for other, more attractive benefits, if the coupons were retained" (*id.*). For a discussion of the potentially deceptive nature of coupon policies, *see Kimball & Hanson, The Regulation of Specialty Policies in Life Insurance*, 62 Mich. L. Rev. 167 (1963).

investors in VIP contracts, as it had agreed to do, Great States determined to reduce these dividend payments by almost one-half, offering investors only fifty percent of the profits derived from VIP contract payments (App. 115, 118, 168). This reduction in dividends was apparently not unanticipated by Great States—the original promise made by the defendants to pay 90 percent of their profits had deliberately been "estimated rather high *to attract new policy owners*" (App. 147). VIP investors, however, were unaware of this, and Great States took efforts to keep them uninformed.

Thus, when investors inquired about this significant reduction in dividends, Great States explained that the lowering of dividends had been recommended to it by its consulting actuaries, and was due "to an increased mortality experience along with the ever increasing costs of operations" (App. 169). In a sense, however, much of this was to prove academic, since at no time did the defendants ever establish the separate accounting entries they promised the plaintiffs they would establish (App. 170).

B. **Proceedings in the District Court.**

Faced with the forfeiture of the payments they had made if they should cease making periodic payments pursuant to their VIP contracts, on July 15, 1969, the plaintiffs instituted this action in federal district court in Alabama. In their complaint (App. 8-34), the plaintiffs basically alleged five causes of action, encompassing claims arising under the federal securities laws, principles of common law fraud and established doctrines of contract law. Only two of these causes of action, however, are relevant on this appeal.

With respect to the two causes of action relevant here, the plaintiffs allege that the VIP contracts they were sold are securities, within the meaning of both section 2(1) of the Securities Act of 1933, 15 U.S.C. 77b(1), and Section 3(a)(10) of the

Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10)—securities which were required to be, but which unlawfully were not, registered with the Commission prior to their distribution to the investing public. Similarly, the plaintiffs also allege that they were induced to purchase these securities on the basis of materially, and deliberately, false misrepresentations of fact.[2]

After some depositions and other discovery had been had, the defendants moved to dismiss this action, (App. 35, 43, 46).[3] Upon consideration of various affidavits, and the briefs and oral arguments of counsel, the district court below issued an order and memorandum, essentially finding, for purposes of the defendants' motions, the facts as set forth briefly above.[4]

Although the district court apparently concluded that

—the sales techniques employed "indicate that the [defendants'] salesmen treated the 'V.I.P.' insurance contract as if it were a 'security' " (App. 192);

—the coupons appended to the VIP contracts "might be compared to those of a bond," and "may lend themselves to abuse * * *" (App. 189); and

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[2] The plaintiffs' complaint also alleges that

—the defendants violated the antifraud provisions of the Securities Exchange Act in connection with a merger between Great States and the defendant State Security Life Insurance Company (App. 21);

—the defendants unlawfully diverted the assets of Great States to the defendant Nimmo for his personal benefit (App. 18); and

—the defendants breached the terms of the VIP contracts they sold to the plaintiffs (App. 17).

[3] The defendants Nimmo and Associates, Inc. and L. W. Nimmo, also sought to quash service of process (App. 43, 46).

[4] The district judge filed his own order, but "the Court wholly adopt[ed] * * *" a "memorandum prepared by its law clerk * * * as its opinion" in this case (App. 159).

—sales of these VIP contracts had been ordered stopped by some states because they were investment contracts that had not been approved for sale to investors (App. 189),

the court, nevertheless placed rather heavy emphasis (App. 192) on the facts that (1) these VIP contracts included a fixed, minimum, death benefit, and (2) the profit participation feature was "denominated as a 'dividend', not as a 'security' or as an ascertainable share of an investment fund" (App. 188). As a result, the court held that, *on their face and without regard to the manner in which these contracts were sold to investors,* the VIP contracts sold to the plaintiffs appeared to be more like traditional insurance contracts than securities in the form of investment contracts. Accordingly, the court dismissed (for failure to state a claim) the plaintiffs' causes of action alleging that the VIP contracts were securities subject to the antifraud and registration provisions of the federal securities laws.[5]

In essence, the district court opined that, as a matter of law, the VIP contracts were insurance contracts, and despite the teachings of the Supreme Court—that in the enforcement of the federal securities laws "it is not inappropriate that promoters'

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[5] The district court also

—denied the defendant State Security's motion to dismiss the breach of contract and common law fraud claims (App. 160);

—granted the motions of the defendants Nimmo and Nimmo & Associates, Inc. to dismiss the common law fraud and breach of contract claims for failure to state a claim as to these defendants (*id.*);

—denied the motions of all the defendants to dismiss the common law and federal statutory counts challenging the propriety of the 1968 merger between Great States and State Security (*id.*); and

—denied the plaintiffs' motion to certify a class as to the VIP contracts, although it reserved any ruling on class certification with respect to the counts of the complaint pertaining to the 1968 merger (App. 160-161).

offering be judged as being what they were represented to be"[6]—advertising and promotional efforts *need not* be considered where the instrument in question offers a fixed death benefit.

C. **The Panel Decision of February 15, 1977.**

The plaintiffs appealed the order of the district court insofar as it dismissed the federal securities laws counts of their complaint relating to the sale of VIP contracts, and insofar as it denied class action status to all the counts of the complaint—both federal and common law—including those involving the VIP contracts.

On February 15, 1977, a panel of the Court of Appeals for the Fifth Circuit, Consisting of Circuit Judges Godbold, Tjoflat, and McCree[7] unanimously held that the district Court should not have limited its inquiry in determining whether the VIP contracts were securities. *Grainger v. State Security Life Insurance Co.*, 547 F.2d 303 (C.A. 5, 1977). Relying upon the Supreme Court's seminal decision in *Securities and Exchange Commission v. C.M.Joiner Leasing Corp.*, 320 U.S. 344 (1943), the panel effectively held, as the Supreme Court had before it, that in determining whether an instrument is a security, it is appropriate to look "outside the instrument itself." 320 U.S. at 355.

Accordingly, although the panel expressly refrained from expressing any view as to whether the VIP contracts are securities,[8]

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[6] *See, e.g., Securities and Exchange Commission v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 353 (1943); *Securities and Exchange Commission v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967); *Cf. Ginzburg v. United States*, 383 U.S. 463, 472 (1966).

[7] Judge McCree, now Solicitor General of the United States, was, at the time of the panel decision, a member of the United States Court of Appeals for the Sixth Circuit, sitting by designation.

[8] The panel did, however, express its "substantial doubts about the significance which the district court attributed to the death benefit

it held that, while the district court's comparison of the VIP contracts with so-called "insurance" contracts held to be securities in other cases was "proper, * * * the court could not stop at this point. In making a determination of what exactly was being offered * * * it was required to consider the methods used in selling the contracts." 547 F.2d at 306. In addition, the panel instructed the district court to consider, among other things, the terms of the offering, the plan of distribution, and the economic inducements held out. *Id.*

Addressing itself to the district court's heavy reliance on the presence of a fixed death benefit in the VIP contracts, the panel also cautioned the district court to consider

> "not only * * * the amount of the death benefit but also * * * the relationship between the size of the death benefit and the size of the 'premium' payments. A showing that the 'premiums' were disproportionately high (in terms of insurance industry norms) in relation to the amount of the death benefit would be persuasive evidence that the VIP contracts were not being bought and sold * * * as insurance policies, but * * * as investment contracts."

547 F.2d at 307.

Accordingly, the panel reversed so much of the district court's decision as had dismissed the plaintiffs' complaint as it related to the VIP contracts, with directions for further proceedings— an evidentiary hearing on the plaintiffs' allegations.[9]

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on the VIP contracts." Thus, the panel stated that the "mere presence of a death benefit of $10,000, or for that matter any given dollar amount, cannot conclusively establish that the insurance features of a particular contract are not simply window dressing on what is essentially an investment contract." 547 F.2d at 307.

[9] Because the district court had also failed to afford the plaintiffs an opportunity to prove that the defendants' alleged misrepresentations were uniform, the panel also vacated the district court's denial of class status to VIP contract holders, holding that, if the plaintiffs

D. **The Fifth Circuit's May 25, 1977 Order Granting Rehearing *En Banc* and Subsequent Order of November 17, 1977 Vacating the May 25, 1977 Order.**

On March 23, 1977, defendants filed a petition for rehearing *en banc*, arguing that the February 18, 1977 panel decision would subject all "participating" insurance policies to the full panoply of SEC regulation. No reply brief was filed by plaintiffs, because Rule 40(a) of the Federal Rules of Appellate Procedure provides that no answer to a petition for rehearing will be received unless requested.

On May 25, 1977 the Fifth Circuit granted rehearing *en banc* and invited plaintiffs (and later the SEC) to submit briefs. On November 17, 1977, *after* lengthy briefs and oral argument before all active judges, the court of appeals entered an *en banc* order vacating the May 25 order and remanded the case to the panel.

E. **The Panel's November 17, 1977 Opinion.**

In a brief *per curiam* opinion, on November 17, 1977, the panel stated:

> "In their petition for rehearing appellees L. W. Nimmo and Nimmo & Associates, Inc. protest that our decision means that an endowment insurance policy containing what they describe as 'a commonly used provision' for the policyholder's participating in surplus can be found to be a security by reason of methods used in its sale. This char-

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cannot "demonstrate the existence and use * * * of" a "standardized sales pitch by all the company's salesmen," then "the district court may quite properly refuse to certify a class on the grounds that common questions of law or fact do not predominate." 547 F.2d at 307-308.

acterization of our decision is not correct. *We did not hold that participating life insurance policies in general are securities or even that the particular contracts in this case are securities. What we have held is that the district court must consider, along with the provisions of the VIP contracts themselves, the totality of the circumstances surrounding their sale, including any oral representations made, in determining whether defendants were selling securities.* [Emphasis supplied]

" 'Endowment policies' vary in their terms and provisions, and participation clauses differ also. In this instance, as pointed out in our opinion the contract in issue is named 'Variable *Investment* Plan' (emphasis added). It purports to guarantee the purchaser '90% of divisible surplus earnings.' Attached coupons physically resemble coupons often attached to bonds. Also, without indicating any views on the relationship between the size of the death benefit and the size of premium payments in the VIP contracts, we pointed out that this relationship is a proper factor for consideration by the district court (as opposed to the substantiality of the death benefit, considered in isolation) in determining whether the facial characteristics of the contracts plus the circumstances of their sale caused them to be securities.

The petition for rehearing is DENIED."

ARGUMENT

I

This Case Is Not Ripe for Review, as the Court of Appeals Has Simply Remanded the Case to the District Court for Reconsideration in Light of Facts Previously Excluded From Consideration. Moreover, in Leaving the Initial Decision to the District Court, the Court of Appeals Has Followed Established Precedent.

As stated in Stern and Gressman, *Supreme Court Practice* § 4-19 at p. 148 (3d ed. 1962):

> The Supreme Court will not usually grant certiorari to review a non-final judgment, such as one remanding the case to the district court for a new trial or one sanctioning the issuance or denial of a preliminary injunction, in the absence of some exceptional reason. As stated in *American Construction Co. v. Jacksonville, T. & K. R. Co.*, 148 U.S. 372, 384, "this court should not issue a writ of certiorari to review a decree of the circuit court of apepals on appeal from an interlocutory order, unless it is necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause." See *Youngstown Co. v. Sawyer*, 343 U.S. 579, 584-5; *Cobbledick v. United States*, 309 U.S. 323, 324-5; *Hamilton-Brown Shoe Co. v. United States*, 240 U.S. 251, 258 (lack of finality "of itself alone furnished sufficient ground for the denial").

In *Brotherhood of Locomotive Firemen and Enginemen v. Bangor & Aroostock R. R. Co.*, 389 U.S. 327 (1967), the Court stated:

> Petitioners seek certiorari to review the adverse rulings made by the Court of Appeals. However, because the

Court of Appeals remanded the case, it is not yet ripe for review by this Court. The petition for a writ of certiorari is denied. See Hamilton-Brown Shoe Co. v. Wolf Brothers & Company, 240 U.S. 251, 257-258, 36 S.Ct. 269, 271, 60 L.Ed. 629 (1916).

Defendants' contention that this case is ripe for review by this Court misconceives the function of the trial and appellate courts. The trial court (or jury) initially determines what the facts are. See, e.g., *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620 (1944). Appellate courts sit as courts of review. Their function is to review alleged errors, not to search out the facts or to try actions *de novo*. See, *e.g.*, *Sartor v. Arkansas Natural Gas Corp.*, *supra; Williams v. National Sur. Corp.*, 257 F.2d 771 (5th Cir. 1958); *Birmingham Post Co. v. Brown*, 217 F.2d 127 (5th Cir. 1955); *Empire Dist. Elec. Co. v. Rupert*, 199 F.2d 941 (7th Cir. 1953), 345 U.S. 909; *Dowell v. Jowers*, 182 F.2d 576 (5th Cir. 1950); *Arstein v. Porter*, 154 F.2d 464 (2d Cir. 1946).

These well-established principles are particularly appropriate here, where the court below has remanded the case to the district court for reconsideration in light of the facts which the district court previously declined to consider and where the trier of fact—in this case, a jury—has not yet resolved any factual disputes which may arise. The purpose of a remand is to allow the facts to be authoritatively established in the district court. Where facts now in the record have not been fully considered, where a trial has not been held, and where a jury has not resolved issues of disputed fact, appellate courts should not render hypothetical opinions. *McDonald v. Kershaw, Butler, Engineers, Ltd.*, 172 F.2d 798 (5th Cir. 1949).

The court of appeals has *not* decided that the "VIP" contracts in question are securities nor has it indicated a view. The court of appeals below has simply held: (A) that the district court erred in dismissing Counts 1, 2 and 3 of the

complaint on the ground that they fail to state a cause of action under the Securities Act of 1933 and the Securities Exchange Act of 1934 (which defendants do not appear to seriously dispute in their petition); and (B) that the district court, in passing on any motion for summary judgment, must take into account *all* of the facts, including facts extraneous to the language of the contract, such as the written sales material, oral sales presentations and expert testimony on the nature of the benefits offered, the cost of the "insurance" benefits, and the "load" for non-insurance benefits of an "investment" nature.

The defendants cite various books of a technical nature dealing with insurance in their petition in this Court (as they did in their briefs below) to argue that the provisions of the "VIP" contracts are "standard" and that the cost of the benefits offered is comparable to the cost of similar endowment benefits offered by major insurance companies.[10]

At oral argument before the court of appeals *en banc*, that court quite properly rejected defendants' efforts, noting that the books were not in the record on appeal, that insurance provisions vary widely, and that any attempt to offer "expert" testimony should be made at the trial court, where the expert can be subjected to cross-examination, rather than on appeal.

In remanding the case, the court of appeals followed sound appellate practice, recognizing that it ought not decide facts in a vacuum or function *de novo* as the arbiter of fact. And

[10] Remand is also particularly approriate in view of some of the arguments urged by defendants in their petition. For example, at p. 14 of the petition, defendants offer comparisons of the "VIP" contracts with Metropolitan Life's "participating" insurance contracts (as to which comparison no evidence exists in the record). At pages 45 and 10-14 of their petition, defendants go outside the record to call upon this Court to function as a *de novo* fact finder, with the assistance of its "common knowledge," to accept certain propositions about the insurance business which defendants assert to be true.

clearly, the November 17, 1977 order vacating the grant of rehearing *en banc* after full briefing and oral argument before the entire court of appeals suggests that the case is not ripe for appellate review and the rehearing petition was meritless. For these same reasons, this Court should not grant *certiorari*.[11]

If the questions presented by defendants' petition are as important as they urge, then would it not be more appropriate for this Court to consider those questions upon the basis of a complete record, including testimony by experts, as suggested by the court of appeals below?

II

Ample Authority Supports the Panel's February 18 Holding That the Parol Evidence Rule Cannot Be Applied in This Case to Bar the Receipt of Evidence of Oral and Written Representations.

As the United States Supreme Court has held, in *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 351-353 (1943):

> "In the enforcement of an act such as this, it is not inappropriate that promoters' offerings be judged as being what they were represented to be."

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[11] Defendants' argument (at p. 3 and at p. 21) that the court of appeals has departed from accepted appellate practices and has imposed undue expense upon the defendants by vacating the *en banc* rehearing and remanding this case to the district court is particularly meretricious. The rehearing petition was defendants' idea—not respondents'—and plaintiffs do not bear the blame where the court, *en banc*, found the rehearing petition to be meritless and where the panel then held that the defendants' rehearing petition had misrepresented the panel's original opinion. Indeed, the expense of defendants' meritless rehearing petition was far more unfair to plaintiffs. For defendants to convert their inaccurate rehearing petition into an argument for a trial *de novo* in this Court to save them expense is utterly without logic.

Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), Rule 10b-5, and Section 12(2) and Section 17(a) of the 1933 Act, 15 U.S.C. §§ 77l(2) and 77q(a), prohibits frauds in connection with "offerings" as well as "sales" of securities. The Congressional prohibition against fraud in connection with offerings was designed to prevent defendants from avoiding the "antifraud" provisions by failure to deliver the "security" promised. The provisions of the Act "cannot be evaded by simply refraining from issuing to the subscriber any documentary evidence of his interest." House Committee Report No. 1338 (Conference Report), 73rd Cong., 2d Sess., p. 39. Cf. *Goodman v. H. Heintz & Company*, 265 F.Supp. 440, 444 (N.D. Ill. 1967), in which the Court upheld the complaint based upon alleged violation of the antitrust provisions of the 1934 Act, notwithstanding the fact that the "security" was nonexistent or fictitious, and was never delivered to plaintiff. If non-delivery of any instrument representing the "security" is not a defense, it would seem that the delivery of an instrument different from that promised should also not be a defense.

In *Svalina v. Big Horn National Life Ins. Co.*, 466 P.2d 1018 (Wyo. 1970), the Supreme Court of Wyoming reversed the trial court's action in directing judgment for defendant under facts quite similar to those presented here. The plaintiff testified in that case that he had understood over a period of years that he was buying "stock" in the insurance company when he was in fact delivered a policy of insurance. The Supreme Court of Wyoming quoted with approval the following language from an article by Kimball & Hanson, "The Regulation of Specialty Policies in Life Insurance," 62 Mich. L. Rev. 167, 204 (1963):

> "The emphasis on investment and a high rate of return tends to mislead the purchaser into believing that he is acquiring primarily an investment rather than a life insurance policy. The market success of some life insurance stocks prepares the way for even more striking deceptions,

> and some sales presentations are so successful that they convince the purchaser that he is acquiring stock in the company."

Under facts somewhat similar to those in the present case, in *Southern Bldg. & Loan Ass'n v. Dinsmore*, 225 Ala. 550, 551-552, 144 So. 21, 22-23 (1932), the Supreme Court of Alabama held that the affirmative charge was properly refused the defendant, stating:

> "The action is for deceit in the sale to plaintiff by defendant, through its agent, of a 'surplus certificate' which was *represented as stock in defendant corporation* of the value of $500, bearing 8 per cent interest, and which could be cashed or surrendered to defendant at any time, plaintiff receiving the $500 with interest.
>
> * * * * * * *
>
> The argument for the affirmative charge is rested upon the possession by the plaintiff of the surplus certificate continuously from the time of its delivery to him and a knowledge of its contents imputed to him by law. But plaintiff did not read the certificate and there is no evidence he had any actual knowledge of its contents, and his proof tends to show that he was lulled into a feeling of security and into any neglect to read the same by the misrepresentations of the agent. Under these circumstances the law imputes to him no knowledge of its contents." [Emphasis added.]

In another case involving a contract sold by an insurance company, the Supreme Court of Alabama stated in *Commercial Cas. Ins. Co. v. Hosey*, 238 Ala. 335, 336-337, 191 So. 343, 344-345 (1939):

> ". . . The complainants had a right to assume that the policy covered the losses as agreed between the parties.
>
> * * * * * * *

The failure of the insured to read the policy was not a violation of a positive duty which the insured owed the insurer, and therefore, was not such negligence as will bar the complainants' right to reformation."

Where one party is guilty of fraud in the inducement, parol evidence is always admissible to reform the written document later delivered to the plaintiff so as to conform to the actual understandings of the parties at the time of the transaction.

The foregoing is not new law, nor is it something which should come as a surprise to the defendants in this action. See 17 Couch on Insurance, Section 66:42 at pp. 278-280 (2d Ed. 1967):

"Where the insurer's agent is authorized to act in the premises, and through his mistake or fraud the policy failed to express the real contract between the parties, or if, by inadvertence or mistake of the agent, provisions other than those intended are inserted, or stipulated provisions are omitted, there is no doubt as to the power of a court of equity to grant relief by reformation of the contract, at least, where there is no fraud or collusion between the agent and the insured. In other words, where a policy of insurance does not represent the intention of the parties solely because of some fault or negligence of an agent of the insurer, equity will reform it so as to make it express such intention."

In *Kansas City Life Ins. Co. v. Cox*, 104 F.2d 321, 324-325 (6th Cir. 1939), construing the law of Alabama, the Court of Appeals noted:

"Insurance policies, unlike other contracts, do not bear the signature of the assured, and the acceptance of a policy, without noticing a mistake, will not always preclude reformation."

In its February 18 opinion, the panel held that the parol evidence rules does not apply to proof of violations of the federal antifraud provisions in the offering of securities. In the alternative, the panel held in fn. 11 to its February 18 opinion that evidence of the representations made would be admissible under the parol evidence rule itself, in order to prove fraud or in order to explain the meaning of words such as "dividends" and "investment" used in the contracts. See Restatement of Contracts §§233 and 238(b).

The panel was clearly correct.

III

The Decision of the Court of Appeals Below Is Not in Conflict With the Tenth Circuit's Decision in Olpin v. Ideal National Insurance Co., 419 F.2d 1250 (10th Cir. 1969), Cert. Denied, 379 U.S. 1074 (1970).

At p. 17, defendants' petition urges that this Court grant *certiorari* on the theory that the decision below is in conflict with the Tenth Circuit's decision in *Olpin v. Ideal National Insurance Co.*, 419 F.2d 1250 (10th Cir. 1969), *cert. denied*, 397 U.S. 1074 (1970).

Inconsistently, however, the defendants' petition (at p. 17) concedes that the *Olpin* court:

> ". . . dealt with another form of participating provision . . . described as a 'bonus fund endorsement' and was unlike the standard form involved in the present case."

Since the *Olpin* decision dealt with a different contract, this Court need not grant *certiorari* to resolve a conflict between the courts of appeal "on the same matter."

In any event, as noted hereinabove, this case is not ripe for mature consideration by this Court. Any review of this case

by this Court should follow reconsideration and resolution of the facts in the district court and subsequent review by the court of appeals, in the ordinary course of events.

IV

The Concerns Expressed by Defendants in Their Petition for Certiorari With Respect to Whether Standard Insurance, Endowment, and Annuity Contracts Must Be Registered With the SEC, and With Respect to Overlapping SEC and State Regulation, Are Based on a Misunderstanding of Congressional Intent and of the Extent of the Overlap.

Defendants' petition (at p. 8-16) expresses concern that standard annuity, endowment and insurance contracts must be registered with the SEC by virtue of the panel's February 18 opinion. Moreover, defendants argue that the February 18 opinion will create unnecessary "duplication" in regulation of insurance companies by the SEC and state regulatory agencies. The defendants appear to argue that the entire panoply of federal securities laws would apply to standard insurance, endowment and annuity contracts issued by insurance companies already subject to state control. But that conclusion does not flow from the stated premise for two important reasons.

The defendants' petition for certiorari fails to recognize that the applicability of the *antifraud* provisions of the federal securities laws—the provisions primarily relied on by plaintiffs in this action—is separate and distinct from the applicability of the various other provisions of those laws such as the Securities Act's registration provisions, which require the filing of a registration statement with the Commission and the delivery of a detailed prospectus in public offerings of securities. Although the antifraud provisions are generally applicable to all securities, various securities are statutorily exempt from the registration

provisions. In this regard, "any insurance or endowment policy or annuity contract or optional annuity contract" issued by a regulated insurance company is exempt from registration by Section 3(a)(8) of the Securities Act, 15 U.S.C. 77c(a)(8), but Congress expressly provided in Section 17(c), 15 U.S.C. 77q(c), that those exemptions should not, and do not, carry with them any immunity from the antifraud protections the federal securities laws provide all investors. By way of example, in *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959), the United States Supreme Court reasoned in the majority opinion that:

> ". . . the term 'security' is broad enough to include any 'annuity' contract. . . ." 359 U.S., at 67-68.

It follows that any "annuity" contract is subject to the antifraud provisions of the 1933 and 1934 Acts. That, however, is only the first step in the analysis which must be made. The Court went on in *SEC v. VALIC, supra,* to consider whether, under all the facts, the "Variable Annuity Life Insurance" contracts were within the exemption from *registration* for "any insurance or endowment policy or endowment contract or optional annuity contract." Based upon an economic analysis of the nature of the contracts in question, in *VALIC* this Court held variable annuity contracts were *not* exempt from registration with the SEC, notwithstanding the fact that such contracts were labelled as "insurance" and notwithstanding the fact that the issuer was an insurance company subject to state regulation.

The very fact that Congress drew a distinction between the applicability of the antifraud provisions and the applicability of the registration provisions indicates that Congress intended that the antifraud provisions would be applicable to "exempt securities," notwithstanding the fact that the issuer is an insurance company subject to regulation by state insurance authorities.

Similarly, in Section 12(g) of the Securities Exchange Act, 15 U.S.C. § 78*l*(g), and in Section 2(a)(17) of the Invest-

ment Company Act of 1940, 15 U.S.C. § 80a-2(a)(17), the problem of an overlap between regulation by the SEC and state agencies was specifically dealt with by Congress in a manner which differs from the result argued for by defendants in their petition. Rather than excluding insurance companies from regulation, Congress granted limited exemptions. Significantly, the antifraud provisions are not included among the areas left entirely to state regulation. Under the approach adopted by Congress, investors in securities issued by insurance companies retain the protections of the antifraud provisions, which provide needed safeguards against false and misleading representations made to investors and which have been held to grant private rights of action to injured investors.

U. S. Government obligations, municipal bonds and "insurance contracts" are exempted from registration with the SEC by § 3 of the 1933 Act. The exemptions provided by § 3, however, do *not* apply to the antifraud provisions. See §§ 12(2) and 17 of the 1933 Act and § 10(b) of the 1934 Act.

Thus, a fraud committed in connection with the purchase or sale of U.S. Government debt securities has been held to be actionable under SEC Rule 10b-5, even though (a) U. S. Government obligations are exempt from registration; and (b) the defendant was an insurance company. See *Supt. of Ins. as Liq. of Manhattan Cas. Co. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971).

Congress itself characterized the contracts exempted by § 3a (8) as "classes of securities." Section 3(a)(8) of the 1933 Act, 15 U.S.C. § 77c(a)(8) states:

> "Except as hereinafter expressly provided, the provisions of this title shall not apply to any of *the following classes of securities:*
>
> * * *

(8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any state or territory of the United States or the District of Columbia . . ." [Emphasis added.]

As noted above, § 3(a)(8) exempts insurance or annuity or endowment contracts from registration, but does not exempt such contracts from the antifraud provisions of the Securities Act, § 12(2) and § 17. Section 12(2) provides, in pertinent part:

"Any person who . . . offers or sells a security (*whether or not exempted by the provisions of section 3* [*of this Act*] *other than paragraph (2) of subsection (2) thereof*), by the use of any means of instrument of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity . . ." [Emphasis added.]

Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a) (which makes it unlawful for any person by the use of the mails or other interstate facilities to obtain money or property by any untrue statement of a material fact or any omission to state a material fact in the offer or sale of any securities), expressly provides:

"The exemptions provided in section 3 shall not apply to the provisions of this section."

Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10), which defines "security" for purposes of the 1934 Act, contains no exemption for insurance contracts, but §3(a)(12) of the 1934 Act, 15 U.S.C. §78(a)(12) defines "exempted securities" to include certain annuity plans.

It is apparent that the intent of Congress was to exempt insurance policies (and government bonds) from *registration*, but not to exempt government bonds or securities issued by insurance companies from the *antifraud* provisions. See, *e.g.*, *SEC v. National Securities, Inc.*, 393 U.S. 453, 468-469 (1969).

V

The Decision Below Is Wholly Consistent With This Court's Prior Decisions; the McCarran-Ferguson Act (Adopted in 1945) Does Not Bar the Application of the Federal Securities Laws to the "Variable Investment Plan" Contracts Sold Plaintiffs in This Action.

Defendants argue (at p. 14 of their petition) that the "VIP" contracts are exempted from the antifraud and registration provisions of the federal securities laws by the McCarran-Ferguson Act, 15 U.S.C. §1012, adopted in 1945, which states:

"(a) The *business of insurance*, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business. (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating *the business of insurance*, or which imposes a fee or tax upon such business, *unless such Act specifically relates to the business of insurance; Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of

October 15, 1944, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law." [Emphasis added.]

By virtue of the McCarran-Ferguson Act, if any Act of Congress is *silent* with respect to insurance, the Act may not be construed so as to invalidate, impair or supersede state laws regulating the "business of insurance."

As we shall show below, the McCarran-Ferguson Act does not require affirmance of the district court's order, for the following reasons:

(a) Only the "insurance business" is dealt with by the McCarran-Ferguson Act. This Court's decisions make it clear that the finder of fact must decide, based on all the evidence, whether particular contracts sold by an insurance company are merely "insurance" or are something other than mere "insurance." In making that factual determination, the finder of fact may properly consider not only the language of the contract, but also the sales representations made, the relationship between the size of the "premiums" paid and the size of the death benefits,[12] and other economic inducements and characteristics of the contracts in question.

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[12] As the panel's February 18 opinion at fn. 12 suggests, the gross annual payments made to Great States by the plaintiffs in this action far exceeded the industry norm for the $10,000 death benefits provided under the "Variable Investment Plan" contracts. Plaintiff Parsons paid $477.87 per year for a contract which included a $10,000 death benefit if his three-year old child died. He was told he would receive "profit-sharing" checks totalling $23,145 on the contract over a 25 year period. (App. 158-158 A).

It is interesting to note that Congress exempted from SEC registration any contract providing for life insurance issued prior to March 23, 1949 (the date of the *VALIC* decision), but only if no more than 49% of the premium or other consideration paid for such contracts was to be allocated to a profit-sharing fund. See P.L. 91-547, §29, quoted herein at fn. 13.

(b) The 1933, 1934 and 1940 Acts of Congress, as amended, *specifically* deal with the business of insurance. Each such Act recognizes and provides for the possible application of such Act to insurance and insurance companies, and includes specific but carefully limited exemptions.

(c) The 1933 and 1934 Acts are cumulative to state regulation and do not "invalidate, impair or supersede" state laws regulating or taxing the business of insurance. See §28 of the 1934 Act and §§ 16 and 18 of the 1933 Act. See also §50 of the 1940 Act.

A. **McCarran-Ferguson is not dispositive of the factual questions presented in this action: Are the V.I.P. contracts merely "insurance contracts"? Do they only involve the "business of insurance"?**

The U. S. Supreme Court's decisions in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967); and *SEC v. Variable Annuity Life Ins. Co.*, make it clear that the McCarran-Ferguson Act does *not* foreclose a factual inquiry with respect to whether particular contracts are "insurance" or something *other* than the "business of insurance."

All three of those decisions were handed down *after* the adoption of the McCarran-Ferguson Act in 1945.

In the last two cases, where no demand for trial by jury of factual issues was involved, the United States Supreme Court, after careful analysis of all the facts, held that "Flexible Fund" contracts and "Variable Annuities," were "securities" subject to registration under the 1933 Act notwithstanding McCarran-Ferguson, notwithstanding §3(a)(8) of the 1933 Act, and notwithstanding the fact that the contracts included significant "insurance" benefits.

In *VALIC*, Justice Brennen observed:

"Obviously they have elements of conventional insurance, even apart from the fixed-dollar term life insurance and the disability waiver of premium insurance sold with some of these contracts (both of which are quite incidental to the main undertaking). They patently contain a significant annuity feature (unless one defines an annuity as a contract necessarily providing fixed-sum payments), and the granting of annuities has been considered part of the business of life insurance.

* * * * * * *

"The contract uses insurance terminology throughout and many of the common features of life insurance and annuity policies are operative in regard to it at this 'pay-in' stage. There are 'incontestability' and 'suicide' clauses (which mainly relate to the term insurance); a 'grace period' allowed for the payment of premiums; a provision for 'policy loans' . . . and a provision for a 'cash value'

. . . And very certainly the commitment of the company eventually to disburse the accumulated values on a life annuity basis once the pay-in period is over is present throughout this period." *SEC v. Variable Annuity Ins. Co.*, 359 U.S. at 80-81, 84. (Brennen, J., concurring.)

Thus, the U. S. Supreme Court declined to foreclose a factual analysis in *VALIC* and *United Benefit*, even though the contracts sold included many "insurance-type" features such as fixed death benefits.

In *VALIC*, the Court noted:

"The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized."

In *United Benefit*, the Court not only made an economic analysis of the contract, but also looked at sales representations made:

> "United's primary advertisement for the 'flexible fund' was headed 'new opportunity for financial growth.' United's sales aid kit included displays emphasizing the possibility of investment return and the experience of United's management and professional investing." 378 U.S. at 211, n. 15.

Based on *all* the facts, the Supreme Court held in *VALIC* and *United Benefit* that the contracts before it were not merely "insurance" or "annuity" contracts, and, therefore, were not exempt from registration with the SEC by virtue of §3(a)(10) of the 1933 Act or McCarran-Ferguson.

B. **The 1933, 1934 and 1940 Acts expressly deal with the business of insurance.**

Congress recognized that the term "securities" as defined by §2(1) of the 1933 Act, 15 U.S.C. 77b(1), was broad enough to include insurance and annuity contracts. Congress provided by Section 3(a)(8), 15 U.S.C. 77c(a)(8), that the *registration* requirements would not apply to "any of the following *classes of securities*: . . . (8) Any insurance or endowment policy or annuity contract."

As originally enacted, the 1933 Act very carefully exempts "any insurance . . . contract" from registration, but the exemption is available *only* if certain conditions are met. To be exempt, the contract must (a) be issued by a corporation; and (b) the corporation must be subject to the supervision of the insurance commissioner (or like agency or officer) of a state or territory of the United States or of the District. Moreover, the exemption provided by Section 3(a)(8) does *not* apply to

violations of Section 12(1) of the 1933 Act or to violations of Section 17 of the Securities Act of 1933.

Since the enactment of the McCarran-Ferguson Act on March 15, 1945, the 1933 Act has been amended several times. Following the March 23, 1959 decision by the Supreme Court in *VALIC*, Congress adopted a statute[13] which exempted from SEC registration certain, but not all, insurance contracts issued prior to March 23, 1959. Congress left in effect the *VALIC* decision with respect to contracts issued after March 23, 1959. Thus, Congress in 1959 impliedly recognized that a factual inquiry is proper to determine whether particular contracts should be exempt from SEC registration. Moreover, Congress impliedly recognized that registration with the SEC of contracts other than mere "insurance" may be required notwithstanding McCarran-Ferguson and §3(a)(8) of the 1933 Act.

After the enactment of the McCarran-Ferguson Act in 1945, the 1934 Act was amended in 1945 to include Section 12(g) of the 1934 Act, 15 U.S.C. §78l(g), which required insur-

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[13] Section 29 of Pub.L. 91-547 provided that:

"The provisions of the Securities Act of 1933 and the Investment Company Act of 1940 shall not apply, except for purposes of definition of terms used in this section, to any interest or participation (including any separate account or other fund providing for the sharing of income or gains and losses, and any interest or participation in such account or firm) in any contract, certificate or policy providing for life insurance benefits *which was issued prior to March 23, 1959*, if (1) the form of such contract, certificate, or policy was approved by the insurance commissioner, or similar official or agency, of a state, territory or the District of Columbia, and (2) under such contract, certificate, or policy *not to exceed 49 percent* of the gross premiums or other consideration paid was to be allocated to a separate account or other fund providing for the sharing of income or gains and losses. Nothing herein contained shall be taken to imply that any such interest or participation constitutes a 'security' under any other laws of the United States." [Emphasis added.]

ance companies to register with the SEC *unless all of the following conditions are met*:

> "(i) Such insurance company is required to and does file an annual statement . . . and such annual statement conforms to that prescribed by the National Association of Insurance Commissioners. . . .
>
> (ii) Such insurance company is subject to regulation by its domicilary state of proxies, consent, or authorization in respect of securities issued by such company and such regulation conforms to that prescribed by the National Association of Insurance Commissioners.
>
> (iii) After July 1, 1966, the purchase and sale of securities issued by such insurance company by beneficial owners, directors, or officers of such company are subject to regulations (including reporting) by its domicilary state substantially in the manner provided in Section 16 of this Act [15 U.S.C. §78p]." Securities Exchange Act of 1934, Section 12(g)(2)(G), 15 U.S.C. §78l(g)(2)(G).

Section 2(a)(17) of the Investment Company Act of 1940, 15 U.S.C. §80a-2(a)(17) defines an "insurance company" for the purpose of certain exemptions, but carefully limits those exemptions to a company:

> ". . . whose *primary and predominant* business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies."

C. **The 1933 and 1934 Acts are cumulative to state regulation and do not "supersede, impair or invalidate" state laws regulating or taxing the business of insurance.**

The federal securities laws *supplement* state regulation, but do not *supersede* state regulation. Those who sell securities

must comply with both federal and state laws in the event the mails or instrumentalities or facilities of interstate commerce are used.

Thus, §§ 16 and 18 of the 1933 Act, §28 of the 1934 Act, and §50 of the 1940 Act make it clear that nothing in those Acts is intended to preclude state regulation, and that the remedies afforded by federal law are intended to be available in addition to all other remedies which investors may have under state law.

As Mr. Justice Brennan observed in *VALIC:*

> ". . . Concurrent regulation, then, was contemplated by the acts as a quite generally prevailing matter. Nor is it rational to assume that Congress thought that *any* business whatsoever regulated by a specific class of officials, the State Insurance Commissioners, would be for that reason so perfectly conducted and regulated that all of the protections of the Federal Acts would be unnecessary. This approach of personally selective deference to the state administrators is hardly to be attributed to Congress. . . ."

In *VALIC, United Benefit* and *National Securities,* the Supreme Court rejected the notion that state regulation "preempts" federal securities jurisdiction over contracts which have an "investment" feature, as well as an "insurance" feature.

Thus, the panel's February 18 opinion is wholly consistent with the McCarran-Ferguson Act, the carefully drawn exemptions provided in the 1933, 1934 and 1940 Acts, and controlling decisions of the United States Supreme Court.

VI

This Case Is Not of Such Importance as to Require Review by This Court Because It Involves a "Specialty," Non-Standard Contract With Special Provisions Which the States Have Prohibited Since 1967.

Great States "Variable Investment Plan" contract is not, as defendants argue, a "standard" contract. It included "coupons" which since 1967 have been prohibited by all or virtually all State regulatory agencies on the ground that such coupons tend to mislead the purchaser. (App. 168, 127, 64). See Departmental Regulation No. 17, Regulations of Alabama Department of Insurance (April 20, 1967, eff. June 1, 1967). Moreover, the word "Investment" was used in the title of the contract and sales materials were developed and used which were designed to emphasize the investment feature of the contract.

The decision of the court of appeals below does not, therefore, affect *all* insurance contracts sold in the United States, as defendants suggest.

The decision below is unexceptional. It followed sound precedent, and did not break "new ground." The decision below dealt with facts (and a contract) unique to this case. This Court need not take up its time with a contract which State regulatory agencies refuse to permit to be sold as "insurance" because it is sold as an "investment" and is misleading.

VII

State Remedies and State Regulation Are Inadequate.

In their petition for certiorari (at pp. 7-8), defendants L. W. Nimmo, et al. argue that plaintiffs should be foreclosed from proceeding in federal court because they have filed lawsuits in

the state courts. The only defendant in the state court suits is the issuer, State Security, which is insolvent. Defendant Nimmo could not be served in Alabama.

In their petition for rehearing before the court of appeals (at pp. 7-11), defendants argued that the application of the anti-fraud prohibitions and registration requirements of the federal securities laws to contracts sold by insurance companies was not necessary because of the existence of state regulation:

> "Such a result [civil remedies under the securities laws] when dealing with such a large segment of the economy as represented by insurance policies, would seem to add a clearly *unnecessary* burden on both the SEC and the courts when the original intent of regulation of the insurance business was to have that burden assumed by the various state regulatory agencies." Appellees' Petition for Rehearing, page 7. [Emphasis added.]

As we shall show below, state remedies and state regulation are inadequate, and investors who are defrauded *by the use of the mails* should be given a *federal* remedy.

A. **State regulation of investments by insurance companies is not uniform and has not prevented failures of insurance companies and misuse of other people's money by insurance companies and promoters.**

Defendants argued below, in their petition for rehearing,

> "*. . . prescribe primarily that investments must be in fixed income securities and mortgages.*" Appellees' Petition for Rehearing, p. 11 [Emphasis added.]

Defendants' suggestion that insurance companies may invest only in gilt-edged bonds and mortgages is incorrect both as a

general proposition and on the facts of this case. Defendant State Security's capital has been declared impaired. Its assets included a cemetery and a loan on property in Mexico (see Exhibit 1 to Nimmo's deposition, and *Skinner v. White*, 505 F.2d 685 at 686 (5th Cir. 1974).

State regulation varies widely from one State to the next, and egregious frauds and failures have occurred notwithstanding state regulation.

Best's Insurance Reports, Life-Health, 1976 (hereinafter Best's 1976], reveals that last year there were 1,836 life insurance companies domiciled in the United States, with $60,980,000,000 in total annual premium income. This indicates an explosive growth since 1950, when there were only 611 life insurance companies, with $7,607,000,000 in total annual premium income. Best's, 1976, at vii, ix; Hanson and Farney, *Life Insurance Companies: Their Promotion and Regulation,* 49 Marq. L.Rev. 175, 176 (1965) [hereinafter Hanson]. Thus, the insurance industry has expanded by 1,225 active companies since 1950, with an increase of annual premium income of over 50 billion dollars.

As remarkable as these figures are, they do not indicate the number of insurance companies which have failed or otherwise disappeared, nor do these figures indicate the losses sustained by the public. One commentator notes that life insurance companies have shown "two outstanding characteristics: a high birth rate and high mortality rate." Hanson at 177. An analysis of Best's Insurance Reports for 1960 through 1976, discloses the following statistics on life insurance companies organized from 1945 to 1976:

	Life Insurance Companies
(1) "Dissolved," "certificate revoked," "withdrew," "placed in receivership," etc. (without mention of reinsurance), to-wit:	353
(2) "Entered agreement of reinsurance and dissolved," "all business assumed," "reinsured by," "purchased and reinsured by," etc., to-wit:	498
(3) "Merged," to-wit:	877

Taken with the number of existing companies as of 1976 (1,836), the total of the changes in status enumerated above (1,726) show the protean nature of the insurance industry since the adoption of the McCarran-Ferguson Act. This volume of corporation transformations, the majority of which are interstate in nature (Best's, 1960, through Best's, 1976), has placed an impossible burden upon state regulators and state courts. In the words of David M. Pack, Commissioner of Insurance and Banking for the State of Tennessee:

> "Senator, in regard to the interstate aspects of these transactions . . . I have stated that I do not feel that any State insurance department can effectively pursue across State lines the problems that arise under the circumstances." *Hearings*, 91st Cong., at p. 9039.

Some corporate mergers, reinsurance agreements and transfers of assets between insurance companies appear to have been undertaken simply in order to keep those who defraud the public one step ahead of the State. As Allan W. Horne, Arkansas Insurance Commissioner, remarked:

> "Asset juggling and fraudulent securities may take as many forms as the ingenuity of the entrepreneur is capable." *Hearings*, 91st Cong., at p. 8817.

"There were some rented securities that these three companies [Nebraska, Arkansas and Minnesota] simply rented from someone." *Hearings,* 91st Cong., at p. 8842.

A large number of recently formed companies are controlled by promoters who measure their own achievements "not in terms of policyholder benefits, but in terms of stock appreciation . . .". Hanson, at 177. Thus, one commentator has noted:

"[A] merger possesses no inherent qualities which compels automatic acceptance of its desirability and worth. Some mergers may be motivated solely for the purpose of enhancing the value of the stock with little regard for its impact upon policyholders' interest. For example, it is not unheard of for an influential member of the board or management of the merged company to receive extra value for his stock unbeknown to other persons in the company." Hanson, at 298-299.

Even mergers, which might seem to be the most innocuous of the transactions set out above, may work to the detriment of the policyholders. What Best's politely terms a "withdrawal" (see category (1) above) needs no explanation.

To place the foregoing statistics in proper perspective, it must be borne in mind that each of the 1,726 companies which failed, merged or withdrew, had a large number of contractholders or policyholders who had paid their monies to that company in the expectation of receiving future benefits. Furthermore, these statistics do not reflect the extent of the dubious practice of shifting blocks of assets, through reinsurance and merger agreements, as to which great concern has been expressed (see generally, *Hearings,* 91st Cong.), because the nature of such transactions makes precise analysis difficult.

The instant case provides a concrete illustration of potential abuses. The plaintiffs originally purchased "Variable Investment

Plan" contracts from Great States Life Insurance Company ("Great States") of Quincy, Illinois. In 1968, Great States was merged into State Security of Indiana. As a result of a 1968 merger with Dependable Life Insurance Company of Mobile, Alabama, State Security assumed substantial obligations to Dependable's policyholders, and acquired as an asset a cemetery (rather than the "fixed income securities and mortgages" referred to at p. 11 of defendants' petition for rehearing below). In another lawsuit arising from alleged diversion of perpetual care funds, State Security was subjected to a $468,408 judgment for contempt. See *Skinner v. White*, 404 F.2d 685 (5th Cir. 1974). Thus, plaintiff-appellants, who had no personal dealings with Dependable Life, were subjected to substantial risks because State Security engaged in a 1968 merger with Dependable (over which the plaintiffs had no control and against which plaintiffs had no readily apparent state remedy).

Moreover, in connection with the 1968 merger of Great States and State Security, plaintiffs' complaint alleges that L. W. Nimmo, a defendant herein, was paid a substantial premium for his stock, out of assets of Great States (presumably purchased with moneys paid in by purchasers of Great States' "V.I.P." contracts). This was accomplished by the device of a loan by a bank to State Security of the moneys which were paid to Nimmo; the bank loan was then repaid after the merger with the proceeds realized from the sale of bonds and other assets of Great States. Thus, the plaintiffs were damaged by the 1968 merger of Great States into State Security.

That was not to be the end of plaintiffs' misfortunes. In 1975, while this appeal was pending, State Security's capital was declared to be impaired, and substantially all of State Security's assets were acquired by Life Insurance Company of Arizona under a Treaty of Bulk Reinsurance. Accordingly, plaintiffs, who had purchased contracts of an Illinois company, now find themselves having to look to an Arizona company, by virtue of

various mergers and reinsurance transactions. We understand that the Arizona company has not qualified to do business in Alabama or Indiana.

B. **The civil remedies available to plaintiffs under state law are inadequate.**

Must plaintiff-appellants now go to Arizona in order to seek redress from a company which has acquired most of State Security's assets? Can Arizona assert jurisdiction over defendants and class members not found within its borders? Cf. *Feldman v. Bates Mfg. Co.*, 143 N.J. Super. 84, 362 A.2d 1177 (1976), in which a State court concluded that it should not certify a class action because it did not have jurisdiction over non-resident class members.

We respectfully submit that an effective remedy should be afforded the plaintiffs and others who were defrauded by the defendants' use of the United States mails. The facts of this case demand the application of nationwide service of process and the national class action remedy available for violations of the antifraud provisions of the federal securities laws.

If a federal remedy is not available, then citizens of the United States may be defrauded by the use of the mails with impunity and may faithfully pay part of their earnings to a life insurance company, only to find themselves with a worthless contract and no adequate remedy. As we have shown above, Congress did not intend by the McCarran-Ferguson Act or by Section 3(a)(8) of the 1933 Act to grant a license to steal, permitting unscrupulous promoters to defraud the public by use of the mails and escape the consequences by raising the shield of "insurance."

C. **Many States do not compel adequate disclosure.**

Some insurance companies have deliberately chosen to offer and sell "specialty" contracts with provisions which cannot be readily compared with other contracts, so as to avoid cost-comparisons by the purchasers. See Kimball and Hanson. "The Regulation of Specialty Policies in Life Insurance," 62 Mich. L.Rev. 167 at 173 (1963):

> "For example, one spokesman for companies issuing specialty policies [a Mr. Ritter, Assistant Secretary of Lincoln National Life Insurance Company of Fort Wayne, Indiana] said:
>
> > 'For the smaller company to meet low-cost competition head-on with the same plan always places them in a tough [competitive] position. This should be avoided, if possible, by the use of unique plans which do not permit comparison with the low-cost Ordinary life policies . . .".

State regulatory agencies, by and large, have not been able to deal adequately with fraudulent and deceptive practices by life insurance companies.

As Dr. Joseph M. Belth, Professor of Insurance, Graduate School of Business, Indiana University, warned:

> "Deceptive sales practices flourish in the sale of conventional life insurance and thus far the states have not shown the willingness to take strong, affirmative action to eradicate such practices. The potential for deception in the sale of the even more complex variable life insurance is frightening to contemplate." Hearings Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary: The Life Insurance Industry, 93rd Cong., 1st Sess., pt. 1, p. 553 (1973).

This Court should not countenance or encourage the use of the mails to defraud purchasers of insurance, annuity and endowment contracts, such contracts are not, and should not be, exempt from the antifraud prohibitions of the federal securities laws.

Moreover, any insurance company which deliberately chooses, as herein, to sell its contracts as an "investment," and which charges substantially more than twice the industry norm for the cost of the fixed death benefits, should be required to comply with the registration and prospectus requirements of the 1933 Act. When Congress passed the 1933 Act, it exempted policies of "insurance" from registration with the SEC. Surely, however, Congress did not intend to exempt from registration contracts such as those involved in this case, in which a company appears to have charged more for the "investment" component than the "insurance" component. In *VALIC* and *United Benefit*, this Court held that an investment contract is not exempt from registration merely because it is labelled as "insurance." The contracts herein, sold "with the investor in mind," are clearly outside the limits of traditional insurance, should not be exempt from registration, and certainly should not be exempt from the antifraud provisions.

The result reached by the panel in its February 18 opinion is not only consistent with the statute and with prior court decisions, but is mandated by the facts of this case and a realistic appraisal of conditions in the insurance industry.

CONCLUSION

The Fifth Circuit's opinion below properly remanded this case to the district court for sifting of all the facts pertinent to whether the VIP contracts are "securities." The common sense opinion of the Fifth Circuit expressed no view on that questions, but simply followed well-settled precedent in specifying the facts which should be considered in the district court.

This case is not ripe for review by this Court. Any such review should await reconsideration and resolution of the facts before the district court and subsequent review by the court of appeals in the usual course.

For these reasons, the petition for certiorari should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that three copies of the foregoing Brief in Opposition to Certiorari were this date served upon all parties by U. S. Mail to John H. Morrow, Esquire, and Robert R. Reid, Jr., Esquire, of Bradley, Arant, Rose and White, Brown-Marx Building, Birmingham, Alabama, 35203; George R. Stuart, III, Esquire, Hardin, Stuart & Moncus, 413 North 21st Street, Birmingham, Alabama, 35203; and Sidney J. Lavender, Esquire, Johnston, Barton, Proctor, Swedlaw & Naff, Twelfth Floor, Bank for Savings Building, Birmingham, Alabama 35203, counsel of record for defendant Life Insurance Company of Arizona; and Harvey Pitt, General Counsel, United States Securities and Exchange Commission, 50 N. Capitol Street, Washington, D. C. 20549.

This the 9th day of May, 1978.

. . . .

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1253

LESLIE W. NIMMO, et al.,

Petitioners,

vs.

CHARLES S. GRAINGER, et al., on behalf of themselves and others,

Respondents.

REPLY BRIEF OF PETITIONERS FOR CERTIORARI

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REPLY BRIEF OF PETITIONERS FOR CERTIORARI

Your petitioners (defendants below), Leslie W. Nimmo and Nimmo & Associates, Inc. (an Illinois corporation dissolved prior to this litigation), respectfully submit this brief in reply to matters raised by respondents (plaintiffs below) in their recently filed brief in opposition to the Petition for Certiorari in this cause. That petition seeks review of the decision of the Fifth Circuit in this $3 million class action subjecting life insurance policies to 10b-5 litigation under the Federal Securities Laws.

Your petitioners submit that an analysis of the opinions—initial and on rehearing—of the panel of the Fifth Circuit clearly shows that those opinions have created new securities law affecting life insurance policies that is appropriate for review by this Court. In addition, that new law cannot be confined to the particular provisions of the life insurance policy here involved that was issued by Great States Life Insurance Company ("Great States") since, as shown by Exhibit A to the Petition for Certiorari, the Great States participating provision that was

the genesis of this litigation is a standard provision comparable to those used in almost 60% of the life insurance policies now in effect in the United States.

I. Because of the "Totality of Circumstances" Test of the Fifth Circuit, this Case is in a Posture Appropriate for Review by the Supreme Court.

The panel of the Fifth Circuit has now held (A-15) that in the sale of participating endowment insurance policies, "the totality of the circumstances surrounding their sale, including any oral representations made," can cause the policies to become "securities" under the Federal Securities Laws. This "totality of circumstances" test, thus, creates a potential security out of any life insurance policy (or, at least, out of all but term insurance policies). While it is true, as urged by plaintiffs, that the Fifth Circuit remanded this case for further proceedings, the importance of the decision below and its applicability to so many insurance policies now in effect makes this case appropriate for review on certiorari.[1]

(A) National Importance of Issue Decided by Fifth Circuit.

Plaintiffs cite the well-known text on *Supreme Court Practice* by Stern and Gressman for the proposition that the Supreme Court will not usually grant certiorari to review a non-final judgment. However, plaintiffs fail to continue the discussion by those authors where they state, "Where there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for certiorari, the case may be reviewed," citing several cases including *Land v. Dollar*, 330 U.S. 731, 734, n. 2 (1947), and *Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685, n. 3 (1949). In those last two cases, this Court reviewed de-

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[1]The broad scope of the decision is indicated by the fact that applicability of this "totality of circumstances" test was discussed in a seminar on the securities laws held in January of this year where members of the SEC and eminent securities practitioners were among the speakers. See BNA Securities Regulation and Law Report, No. 438, page A-26 (Feb. 1, 1978).

cisions raising important jurisdictional questions when the court of appeals had reversed the granting of a motion to dismiss (as contrasted with summary judgment here) and had ordered the case remanded for trial. Stern and Gressman, *Supreme Court Practice* (4th Ed., 1969), Sec. 4.19. Further, in addition to the securities cases cited at pg. 22 of the petition, this Court has recently granted certiorari in *Daniel* where the case was appealed from denial of motions to dismiss.[2]

It is obvious that lengthy proceedings, consuming time of the lower court and expense of the judicial process, will surely ensue if this case is remanded for further consideration under the above "totality of circumstances" test. It, thus, would be most counter-productive in judicial administration for this case now to be remanded, tried and then appealed in order for it finally to be determined whether a participating or endowment life insurance policy can become a security by reason of its method of sale. Consequently, the case is in a posture necessitating that that question, decided by the panel of the Fifth Circuit, be reviewed now.

That the decision by the panel of the Fifth Circuit has broad ramifications that can affect many insurance policies is clearly shown merely by reference to the factors cited as examples at the end of its short opinion on denial of rehearing. The suggestion that a high premium/death benefit ratio can cause an insurance policy to become a security obviously affects all endowment policies and especially term endowments (i.e. those where the premiums are paid for a short term rather than, for example, until age 65). In addition, any policy that carries coupons would also be subject to examination in a court proceeding. Lastly, any policy where the word "investment" was mentioned in its sales literature (even though all policies except term, of necessity, must have an investment element) and any instance where an insurance company salesman emphasized the investment element of that policy would obviously become potential securities. The doors of the federal courts are, thus,

[2] *Daniel v. International Brotherhood of Teamsters, etc.*, 561 F.2d 1223 (7th Cir. 1977), cert. granted 46 U.S.L.W. 3512 (U.S., Feb. 21, 1978).

opened to 10b-5 litigation over all such policy elements. Petitioners, therefore, submit that it is clear that this issue is of national importance and is now appropriate for decision by this Court.

(B) Procedural Status is Appropriate For Review.

At many instances in their opposition brief, plaintiffs urge that the case be remanded because it was decided by the District Court on motions to dismiss rather than motions for summary judgment. This is, however, incorrect and, knowing that this issue had become involved in the case on the appellate level, petitioners thought they had given ample references to correct this misapprehension in their initial petition (pg. 21).

This case was argued on appeal at the same time as another securities case involving life insurance policies where the same attorneys represented the plaintiffs—*Hilgeman v. National Insurance Company of America,* 547 F.2d 289 (5th Cir. 1977), which, although not a companion case in the lower courts, was treated as a companion case by the Fifth Circuit. The procedure in *Hilgeman* was, however, entirely different from that in *Grainger.* In *Hilgeman* there had been an order blocking discovery; and the case, which involved a number of complicated procedural questions, was appealed from granting of motions to dismiss under Rule 12(b). However, the situation was different in *Grainger* where the complicated procedural questions did not exist and where the District Court decided the case on summary judgment under Rule 56.

This is made clear by the court's order of June 20, 1977 (A-17), in which the District Court elected "to treat the motion to dismiss filed in behalf of each defendant as a motion for summary judgment" and to allow the parties to submit any affidavits or other documentary evidence which they may deem relevant to determination of whether the insurance contracts involved constitute "securities". There had been no order blocking discovery as erroneously indicated in the Fifth Circuit's panel decision at 547 F.2d 305 (headnote 1) (A-8); and the District Court had before it extensive depositions, most of

which were taken by plaintiffs. Further, the District Court in its final opinion did clearly state that the nature of the case "warrants the consideration of more evidence than is usually appropriate to motions to dismiss" (A-23), thereby showing that it considered evidence extrinsic to the face of the insurance policies in determining whether they were securities. In fact, the District Court clearly showed such consideration where it concluded after reviewing plaintiffs' evidence, "At most, plaintiffs indicate that the salesman treated the 'V.I.P.' insurance contract as if it were a 'security' ", thereby showing that the court considered all the evidence that plaintiffs submitted through depositions and by affidavits in reaching its decision. Notwithstanding the above status of the record, plaintiffs state in their opposition brief, at page 3, "Thus, the District Court's order of June 5, 1975 (its final order) appears to have been entered pursuant to Rule 12(b), rather than Rule 56, as defendants' claim." This is simply not true. Plaintiffs should know it is not true because they submitted affidavits in response to the court's previous order directing that the case be decided on summary judgment.

It is obvious that the Fifth Circuit got the procedural status of the two cases confused because it referred to there being an order blocking discovery in *Grainger* when there was no such order in *Grainger* but there was one in *Hilgeman.* However, in order to preserve the "totality of circumstances" test, plaintiffs are now urging a perpetuation of that error. If the plaintiffs had any further evidence, in addition to the lengthy depositions and the affidavits they submitted, they should have brought it forward before the lower court and not now later by urging that the case should be remanded.

As a result of the foregoing, it will be seen that any application of the parol evidence rule referred to by plaintiffs did not actually occur in *Grainger* and, if it were applicable anywhere, it would be applicable to *Hilgeman,* which is not now before this Court. Thus, the discussion in Part II of plaintiffs' opposition brief is actually inapplicable to the procedural status or facts involved in *Grainger*. Petitioners, therefore, strongly

urge that this case is in a proper procedural status to be brought before this Court for determination. To hold otherwise would clearly not be in the efficient administration of the judicial process.

(C) Evidentiary Status is Appropriate for Review.

Plaintiffs claim, at page 16 of their opposition brief, that the defendants cite "various books of a technical nature" and that, therefore, the case should be remanded. We submit that this clearly is a mistake in application of rules of evidence and the citation of authorities. The references to which plaintiffs refer are two. The first is to Huebner & Black, *Life Insurance* (8th Ed. 1972), for a sample standard form of life insurance participating provision. This provision is the genesis of this litigation where plaintiffs have contended that the life insurance exemption or exclusion from the Federal Securities Laws should be confined to policies of pure risk insurance (i.e. term) and have tried to equate the Great States participation provision with the special fund used in *United Benefit*.[3] In the lower court, the Great States participating provision was compared with actual provisions of other contracts in wide use in Alabama. On rehearing, petitioners referred to a standard text so that the court would have a textbook for ready reference rather than presenting provisions of specific contracts; but the provisions are all substantially similar and reflect the nature of standard participating clauses. We submit, therefore, that there is nothing to be gained by remanding this case for consideration of whether the Great States participating provision is like the standard clauses of other specific policies or like the standard clause contained in Huebner & Black (which clearly appears from the comparison set forth in Exhibit A to the petition).

The other insurance text to which plaintiffs refer is *Flitcraft Compend* (1962), cited to show a comparison between the premiums charged by leading life insurance companies in the United States for similar policies issued in the same year (1962)

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[3]*S.E.C. v. United Benefit Life Insurance Co.*, 387 U.S. 202 (1967).

as the Great States policy being attacked here. In actual effect, the pricing of a life insurance policy should probably not affect whether it is a "security" or not, in which case this attack by plaintiffs would be entirely irrevelant. However, in the event it might be considered relevant by the court, petitioners were merely pointing out that the premium/death benefit ratio for the Great States policy was not out of line and, in fact, was comparable to those of major life insurance companies. This issue was not raised in the lower court or by plaintiffs on appeal but only by the Fifth Circuit in its initial panel decision. Thus, it was necessary, on rehearing, to present the information through reference to a recognized work containing data respecting life insurance policies. This we submit is entirely proper since *Flitcraft* is a standard copyrighted text, published annually and independently from any insurance company, that sets forth quotations for various life insurance policies issued by the leading life companies doing business in the United States. Further, as such, the courts can take judicial notice of it.[4] In fact, *Flitcraft Compend,* which should be found in any library containing insurance publications, could be considered similar to Best's Insurance Reports, which are cited by plaintiffs at least twice in their own brief.

Petitioners submit, therefore, that the evidentiary status of this case also shows that it is in a posture to be decided by this Court. This is not having an appellate court try a case de novo as contended by plaintiffs; it is merely permitting the court to avail itself of appropriate information available in recognized works of reference.

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[4]See *Iberian Tankers Co. v. Gates Construction Corp.,* 388 F.Supp. 1190 (S.D.N.Y. 1975) (reference to publication of investment banking firm, "Salomon Bros. Statistical Yields", for judicial notice of interest rate on 3-month U. S. Government securities); *Baumel v. Rosen,* 283 F.Supp. 128 at fn 8 (D Md. 1968), aff'd in part, rev'd in part on other grounds 412 F.2d 571 (4th Cir. 1969), cert. den. 396 U.S. 1037 (1970) (reference to *Wall Street Journal* for judicial notice of trading prices of a particular stock). "In accord with the usual view, judicial notice may be taken at any stage of the proceedings, whether in the trial court or on appeal." Comment to Rule 201 (f), Federal Rules of Evidence.

II. The Great States Policy is Not a Non-standard Policy that would Preclude Application of the Fifth Circuit's Decision to Many Other Insurance Policies.

Plaintiffs contend that the Great States life insurance policy is a "specialty" policy, mentioning at numerous points in their opposition brief that it is not like other policies and, therefore, not meriting this Court's review. It seems obvious, however, from a comparison of the participating provisions set forth in Exhibit A to the petition that the Great States participating provision is a standard one. Plaintiffs, thus, seek to emphasize two factors which they claim make the policy a specialty. The first is distribution with the policies sold in Alabama of a copy of the Illinois law requiring that a certain percentage of profits from a company's participating business inure to the benefit of the participating policyholders. See the provision set forth at A-3,4 and discussed at footnote 3 of the petition. We submit that it is most difficult to ascertain how communication to an insured of a specific provision of the laws governing his policy would serve to make that policy a so-called "specialty" policy.

The other factor relied on by plaintiffs—and done so extensively in their opposition brief—is the fact that the Great States policy contained coupons, which were of fixed amounts and could be used for various options including the reduction of premiums or purchase of additional insurance, thereby showing their clear relation to the insurance policy to which they were attached. This matter is discussed in footnote 7 on pages 14-15 of the petition where it is noted in Appleman, *Insurance Law and Practice,* that, although coupon policies are not widely used, "they are a standard form of insurance." Coupling that with the fixed dollar amounts of the coupons, it would seem that their presence could hardly cause an insurance policy to become a "security". Thus, they are irrevelant to the basic issue here, which is whether an insurance policy can become a security.[5]

[5]Plaintiffs cite Departmental Regulation No. 17 of the Alabama Insurance Department on several occasions for the proposition that coupon policies are illegal. Actually it is Departmental Regulation No. 47, a copy of Rule 2 of which pertains to coupon policies and is set forth as an ex-

Your petitioners submit that plaintiffs—and, in fact, the panel of the Fifth Circuit—are clouding the true issue involved in this case by trying to focus on such matters as attachment of coupons of fixed value to a policy or on distribution with it of the participating provision of Illinois law, when it is obvious the true issue is: Can method of sale change a life insurance policy with a standard participating provision into a "security", i.e. can method of sale create a "security" out of something that Congress determined, in enacting the Federal Securities Laws, is not a "security"?

While plaintiffs make the general allegation that petitioners have misstated the facts, no specific examples are given. However, in their statement of facts, which presumably is intended to supplement that contained in the petition, they quote substantially from a summary contained in the SEC's amicus curiae brief submitted to the Fifth Circuit on the rehearing where the SEC, in general, supported plaintiffs' position by an advocate-style brief.[6] The SEC was obviously removed from the trial proceedings in the case below and, we submit, took certain liberties in interpretation of the District Court's decision. These inaccuracies are, thus, now repeated in the opposition brief before this Court. The cited references do not necessarily support the propositions for which they are cited; and an examination of those references shows that they do not actually alter the summary of the facts in the petition. However, we do not feel it is the province of a petition for certiorari to burden this

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tension of the appendix (A-55) and attached hereto since it is not set forth in plaintiffs' opposition brief. This regulation was adopted in 1967 — five years after the sale of the Great States policies here in issue — and even then does not prohibit coupons but only requires that, if a policy contains them, the premiums charged for the coupon benefits be stated separately from those for the benefits allocable to the policy without coupons. That is hardly the same as saying that coupons have been prohibited. Further, even if the regulation had prohibited them, it would merely show the exercise of state regulation, of which plaintiffs appear to complain, and not that the insurance policy had somehow been converted into a "security".

[6]The references to "App." in the opposition brief are, thus, to the appendix before the court of appeals and not before this Court.

Court at this stage of the proceedings with discussion of such peripheral factual matters (although we would be glad to do so). Nevertheless, two such misconstructions should be mentioned now:

(1) The Great States contract is characterized as including "a fixed, *minimum*, death benefit" (emphasis supplied), thus implying that there are some variable benefits that might be payable above that minimum. This is obviously an instance where it was attempted to force the facts of this case into the mold of *United Benefit,* in which there was a minimum death benefit lumped together with a flexible fund that would, in practical effect as this Court found, determine the actual death benefit. In the Great States policy, there is no minimum death benefit nor is there a maximum. It is simply a fixed amount. In the policy discussed before the Fifth Circuit, the death benefit was $10,000, the endowment benefit was the same should the policyholder live until the maturity date of the policy, the coupons were fixed amounts, and there were fixed cash values. The only feature that was not a fixed dollar amount was the standard participating provision, which is and has been customary in the insurance industry and which has been analyzed by legal authorities, such as Justice Brennan in *VALIC,*[7] not to constitute a "security".

(2) It is stated that the District Court concluded that "sales of these VIP contracts had been ordered stopped by some states." Reference is to the District Court's opinion at App. 189 (A-46), which, in turn, refers to a letter from the Alabama Department of Insurance to Great States in 1963 (after the policies in question here had been sold) requesting a discussion of the type of policies and that they no longer be issued until the matter had been concluded. Plaintiffs' evidence does not show the final disposition of that inquiry; however, in the state court suit by Mr. Henson, one of the named plaintiffs in the instant case, it is shown that the Department (through a Mr. Easterwood) later characterized this same policy as "just a life

[7]*SEC v. Variable Annuity Life Insurance Co.,* 359 U.S. 65 (1969).

insurance policy participant". *State Security Life Insurance Co. v. Henson,* 288 Ala. 497 at 501, 262 So.2d 745 at 748 (1972). That case only serves to underline some of the reasons life insurance policies, such as the participating policy involved in the present case, are not "securities", viz. that they are and have been subject to state regulation and further that claims on such policies are cognizable in the state courts. As the District Court concluded at A-46, "This fact does not change the exempt status of these insurance policies; rather it confirms the Congressional choice, embodied in the insurance exemption, to leave the regulation of insurance and its sale to the state. Cf. *VALIC,* 359 U.S. at 75 (Brennan, J., concurring)."

Much of the discussion at the end of the opposition brief is directed toward alleged deficiencies in state regulation of insurance. We submit, however, that this is not an issue in this case. If it is an issue at all, it is one before Congress to determine whether state regulation of insurance should be superseded by some federal regulation. To subject insurance policies to federal regulation through 10b-5 litigation not only would create lack of uniformity and uncertainty in results but also would be contrary to the intent of Congress in enacting the Federal Securities Laws (see pg. 9 of the petition) and the admonitions of this Court in *Blue Chip Stamps, United Housing* and *Hochfelder.*[8]

[8]*Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975), *United Housing Foundation v. Forman,* 421 U.S. 837 (1975), and *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976).

CONCLUSION

For the foregoing reasons and those expressed in their petition for certiorari, petitioners respectfully urge this Court to grant their petition for a writ of certiorari.

Respectfully submitted,

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DEPARTMENTAL REGULATION NO. 47

APRIL 20, 1967

Effective June 1, 1967

* * * *

Rule 2. No insurance company, insurance agent, solicitor or insurance company representative shall deliver within this state, or issue for delivery within this state, a policy of life insurance containing benefits in the form of "coupons" or "guaranteed annual endowment" benefts unless the premium charged for the insurance coverage and the premium charged for the "coupons" or "guaranteed annual endowment" benefits are prominently specified in the policy separately from each other in dollar amounts. This Rule 2 shall not apply to any policy in which the amount of any pure endowment or periodic benefit or benefits payable during any policy year is greater than the total annual premium for such years.

In connection therewith, the policy must provide for a distinction between the surrender values available under the insurance coverage as distinct from the "coupon" or "guaranteed annual endowment" benefits. This is to be accomplished by the use of a separate "table of values" in the policy.